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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

October Term, 1946

No. 847

THE UNITED STATES, PETITIONER

vs.

THE MUNSEY TRUST COMPANY OF WASHINGTON, D. C., RECEIVER

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED JANUARY 3, 1947

CERTIORARI GRANTED MARCH 3, 1947

SUPREME COURT OF THE UNITED STATES

October Term, 1946

No. 847

THE UNITED STATES, PETITIONER

vs.

THE MUNSEY TRUST COMPANY OF WASHINGTON, D. C., RECEIVER

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

INDEX

1 In the Court of Claims of the United States

No. 46251

THE MUNSEY TRUST COMPANY OF WASHINGTON, D. C., RECEIVER

vs.

THE UNITED STATES

History of proceedings

The original petition was filed November 14, 1944.

On February 11, 1946, on motion made therefor and allowed by the court, an amended petition was filed which is as follows:

Amended Petition

Filed Feb. 11, 1946

To the Honorable, the Court of Claims:

1. The plaintiff, The Munsey Trust Company, of Washington, D. C., is a banking corporation under the laws of the District of Columbia, and brings this action as receiver appointed by the District Court of the United States for the District of Columbia in an action styled Irving Klein, plaintiff, v. Henry Morgenthau, Jr., Secretary of the Treasury of the United States, et al., defendants, being Civil Action No. 11643 in said Court.

2. The Federal Contracting Corporation, a corporation under the laws of the State of New York, entered into several contracts with the United States, acting through the Public Buildings
2 Administration for the painting and repair of various public buildings of the United States as follows:

Post Office, Denver, Colorado	Contract WA-2-pb-531.
Post Office and Court House, Tulsa, Oklahoma	Cotnract WA-2-pb-629.
Post Office, Whitewater, Wisconsin	Contract WA-2-pb-597.
Customs House, Portland, Maine	Contract WA-2-pb-609.
Post Office, Skowhegan, Maine	Contract WA-2-pb-702.
Post Office, Gallup, New Mexico	Contract WA-2-pb-806.

The work under said contracts was fully performed by the Federal Contracting Corporation and progress payments were made on account thereof. At the conclusion of such work there remained due and owing from the United States to the contractor on account of each of said contracts the following amounts:

Denver, Colorado, Contract WA-2-pb-531	$1,423.67
Tulsa, Oklahoma, Contract WA-2-pb-629	4,701.10
Whitewater, Wisconsin, Contract WA-2-pb-597	910.00
Portland, Maine, Contract WA-2-pb-609	3,649.00

Skowhegan, Maine, Contract WA-2-pb-702	$391.60
Gallup, New Mexico, Contract WA-2-pb-806	954.68

3 3. The Aetna Casualty and Surety Company, a corporation under the laws of the State of Connecticut, became surety for the contractor upon its bonds securing performance of the work under each of the above-mentioned contracts as well as payment to all persons furnishing labor and material for use and which was used in the work. The Federal Contracting Corporation failed to pay various persons who had furnished labor and material for use in said work and the same were paid by The Aetna Casualty and Surety Company pursuant to the obligations of its several bonds. The amounts which the Federal Contracting Corporation failed to pay to furnishers of labor and material in connection with each contract and which were paid by The Aetna Casualty and Surety Company are as follows:

Denver, Colorado, Contract WA-2-pb-531	
Tulsa, Oklahoma, Contract WA-2-pb-629	
Whitewater, Wisconsin, Contract WA-2-pb-597	$8,640.10
Portland, Maine, Contract WA-2-pb-609	648.00
Skowhegan, Maine, Contract WA-2-pb-702	2,528.00
Gallup, New Mexico, Contract WA-2-pb-806	35.00
	1,214.83

4. On October 18, 1940, the Federal Contracting Corporation submitted a bid in the sum of $20,743 for the painting of the United States Post Office, Market, 17th and 18th Streets, St. Louis, Missouri. The said bid was accepted by the United States,
4 but the Federal Contracting Corporation failed to enter into said contract and failed to give to the United States the bond required in connection therewith, as a consequence of which the United States caused the work to be performed at a cost of $27,867, which together with the cost of readvertising the work in the amount of $22.50, raised a charge against the Federal Contracting Corporation of $7,146.50.

5. Thereafter, Irving Klein, as a stockholder of the Federal Contracting Corporation instituted an action in the District Court of the United States for the District of Columbia entitled Klein v. Morgenthau, Secretary of the Treasury, et al., Civil Action No. 11643, wherein he sued Henry Morgenthau, Jr., Secretary of the Treasury of the United States; William A. Julian, Treasurer of the United States; W. E. Reynolds, Commissioner of Public Buildings; The Federal Contracting Corporation; Charles Picoult; Frank Wunchel; and The Aetna Casualty and Surety Company. The plaintiff in said action sought the appointment of a receiver for the amounts payable by the United States under the several contracts herein mentioned and the marshaling of such amounts and equitable distribution thereof to such of the parties as might be properly entitled thereto. Subsequently this plain-

tiff was appointed receiver in the said proceedings and directed to collect from the United States all moneys due under the said contracts. It was further directed to hold the proceeds of such contracts for the reimbursement of The Aetna Casualty and Surety Company for expenditures made by it in the payment of furnishers of labor and material under said contracts. In the same order the action of the plaintiff was dismissed as to the defendants Henry Morgenthau, Jr., Secretary of the
5 Treasury of the United States; William A. Julian, Treasurer of the United States; and W. E. Reynolds, Commissioner of Public Buildings. A copy of said order is attached hereto as Exhibit A.

6. Thereafter the plaintiff made demand upon the United States for the proceeds of the several contracts. Plaintiff was paid by the United States the balances due under Contract WA-2-pb-597, Whitewater, Wisconsin, in the amount of $910, and Contract WA-2-pb-702, Skowhegan, Maine, in the amount of $391.60. The General Accounting Office thereafter made settlements as follows:

Denver, Colorado, Contract WA-2-pb-531.—The final balance payable under this contract in the amount of $1,423.67 was applied against the indebtedness of the contractor to the United States arising out of its default under its bid for painting and repairing the St. Louis, Missouri, post office.

Tulsa, Oklahoma, Contract WA-2-pb-629.—The final balance due under this contract in the amount of $5,116.10 was applied to the extent of $4,353.17 to the default of the contractor under its bid for painting and repairing the St. Louis, Missouri, post office. $762.93 of this balance was paid to and has been received by the plaintiff.

Portland, Maine, Contract WA-2-pb-609.—The final balance payable under this contract in the total sum of $3,649 was settled in favor of the plaintiff and paid to it.

Gallup, New Mexico, Contract WA-2-pb-806.—The final balance payable under this contract in the sum of $954.66 was applied in its entirety to the indebtedness of the contractor arising
6 under its default in connection with its bid for painting and repairing the St. Louis, Missouri, post office.

There has accordingly been received by the plaintiff on account of all of the contracts above-mentioned the total sum of $5,713.53.

7. The plaintiff is informed and believes that The Aetna Casualty and Surety Company has an equitable lien upon the proceeds of the said several contracts to the extent of the amounts paid by it under the obligation of its bonds relating to each of said contracts, as a consequence of which the payments finally due under the several contracts were not subject to a set-off by the United

States on account of independent claims in the manner in which such set-off was made by the General Accounting Office.

8. The plaintiff and The Aetna Casualty and Surety Company protested the making of such set-offs, copies of which protests constitute Exhibits B and C hereto. The plaintiff's protests were denied by the Acting Comptroller General of the United States, a copy of which said denial forms Exhibit D, hereto attached. The receiver reported to the United States District Court the action taken upon its protest and was authorized to institute a proceeding in this Court for the recovery of such amounts. A copy of said order is attached hereto and forms Exhibit E. There is justly due and owing by the United States to the Federal Contracting Corporation the sum of at least $3,568.23, which is impressed with an equitable lien in favor of The Aetna Casualty and Surety Company, which said lien is paramount to any right of set-off in the United States arising from sources independent of the contracts under which such sums are payable.

7 9. No action has been had on said claim in Congress or by any of the other departments. No person other than the plaintiff is the owner thereof or interested therein other than as set out in this petition. No assignment or transfer of this claim or any part thereof or interest therein has been made other than that made to the plaintiff by virtue of its appointment as receiver. The plaintiff is justly entitled to the amount herein claimed from the United States after allowing all just credits and offsets. The plaintiff has at all times borne true allegiance to the Government of the United States and has not in any way voluntarily aided, abetted or given encouragement to rebellion against the said Government. The plaintiff claims $3,568.23.

HINTON & HERON,
By ALEXANDER M. HERON,
Munsey Building, Washington 4, D. C.,
Attorneys for Plaintiff.

[*Duly sworn to by C. D. Ratcliffe jurat omitted in printing.*]

8 *Exhibit A to amended petition*

In the District Court of the United States for the District of Columbia

Civil Action No. 11643

KLEIN, 875 LONGFELLOW AVENUE, NEW YORK, N. Y. PLAINTIFF

v.

MORGENTHAU, JR., SECRETARY OF THE TREASURY OF THE UNITED STATES, WASHINGTON, D. C., ET AL., DEFENDANTS

ORDER DISMISSING CAUSE AS TO CERTAIN DEFENDANTS AND APPOINTING RECEIVER

Upon consideration of the motion of the Secretary of the Treasury, Treasurer of the United States and Commissioner of Public Buildings, and the consent of counsel for all parties appearing herein, it is, by the Court, this 8th day of January, 1942,

Ordered:

1. That this action be and the same hereby is dismissed as to the defendants Henry Morgenthau, Jr., Secretary of the Treasury of the United States, William A. Julian, Treasurer of the United States, and W. E. Reynolds, Commissioner of Public Buildings, with respect to all claims made herein in the complaint, answers, cross-claims and counterclaims.

2. That the Munsey Trust Company of Washington, D. C. be and it hereby is appointed Receiver in this cause to demand and receive from the United States the proceeds of all of the
9 following contracts between the United States and the defendant Federal Contracting Corporation, a corporation:

Contract WA-2PB-531	Denver, Colorado.
Contract WA-2PB-629	Tulsa, Oklahoma.
Contract WA-2PB-597	Whitewater, Wisconsin.
Contract WA-2PB-600	Portland, Maine.
Contract WA-2PB-702	Skowhegan, Maine.
Contract WA-2PB-806	Gallup, New Mexico.

with full power and authority to give acquittance therefor to the United States, and to endorse any check or checks which may be made payable to the Federal Contracting Corporation in connection therewith and to present the same for payment by the United States, and to collect the proceeds thereof.

3. That the proceeds of all collections made by the Receiver pursuant to this order shall be held for the reimbursement of the defendant The Aetna Casualty and Surety Company for expendi-

tures made by it in the payment of furnishers of labor and material under the several contracts of the Federal Contracting Corporation. The Receiver shall upon making collection of funds from the United States, as herein authorized, report the same to the Court and hold the same subject to the order of this Court.

JENNINGS BAILEY,
Justice.

10 We Consent:

VERNON LOWREY,
HENRY GOODMAN,
Attorneys for Plaintiff.

EDWARD M. CURRAN,
BERNARD J. LONG,
United States Attorney, for the Secretary of the Treasury, Treasurer of the United States and Commissioner of Public Buildings.

HINTON & HERON,
By ALEXANDER M. HERON,
Attorneys for The Aetna Casualty and Surety Company.

HUDSON, CREYKE & HUDSON,
By ANDREW A. LIPSCOMB,
Attorneys for Frank Wunchel.

WILLIAM T. HANNAN,
Attorney for the Federal Contracting Corporation.

11 *Exhibit B to amended petition.*

THE MUNSEY TRUST COMPANY
WASHINGTON 4, D. C., MAY 10, 1944.

To the Honorable
The Comptroller General of the United States,
Washington, D. C.

Re: Claims No. 0980866–(1), (2), (4), Certificates 0750427–429–439–964—Klein v. Morgenthau, Civil Action No. 11643

SIR: Your office settled the above entitled contracts in favor of the Munsey Trust Company, as receiver appointed in the above entitled action. The appointment was made by order of the District Court of the United States for the District of Columbia, dated January 8, 1942, in Civil Action No. 11643 known as Klein v. Morgenthau, Jr., Secretary of the Treasury of the United States, et al., defendants. I believe you have a copy of the order of appointment; if not I will be glad to furnish same to you.

By paragraph No. 2 of the decree, the undersigned was directed to demand and receive from the United States the proceeds of these contracts made with the Federal Contracting Corporation.

By paragraph No. 3, as receiver, it was directed to hold all collections for the reimbursement of The Aetna Casualty & Surety Company for the expenditures made by it in the payment of furnishers of labor and material under the several contracts of the Federal Contracting Corporation.

The receiver is directed, upon making collection of funds from the United States as authorized, to report the same to the court and hold the same subject to the order of the court.

12 It would appear that in making settlements with the receiver with reference to these respective contracts, certain sums were withheld to be applied to the contractors' indebtedness to the United States.

According to an affidavit made on behalf of The Aetna Casualty & Surety Company transmitted herewith, that company paid certain moneys pursuant to the obligation of its bond to persons who furnished labor and material for use which was used in the work required under the contracts. The record in these cases will show that the surety protested, prior to the settlements, against the making of any set-offs because of charges against the contractor which arose independently of the contract. (See letter on behalf of the surety to your office dated December 17, 1942.)

Since the time of the settlements made by your office, we are advised the Court of Claims of the United States handed down its decision in the case of Maryland Casualty Co., a corporation, vs. United States, No. 45659, decided January 3, 1944. We respectfully refer you to the opinion of the court in that case. This opinion has been interpreted by us to conclude that the proceeds of a construction contract made by the United States are subject to the impression of an equitable lien in favor of a surety which pays persons who have furnished labor and material for use in the work and that this equitable lien is paramount to the right of set-off otherwise available to the United States in connection with items independent of the contract. It would accordingly follow that the proceeds of the contracts for work at Gallup, New Mexico and Tulsa, Oklahoma, are impressed by an equitable lien in favor of The Aetna Casualty and Surety Company to their full extent, since we are advised neither of them is sufficient to reimburse the surety for the payments made by it under its bond.

It follows that the application of the rule laid down in the Maryland Casualty Company case to the cases in hand have the effect of first impressing an equitable right to the contract bal-

ances in favor of the surety to the extent necessary to reimburse it for payments made by it under its bonds. The following results:

13 Contract	Balance	Claims paid by surety	Payable to surety
WA-2PB-597	$910.00	$648.00	$648.00
WA-2PB-702	391.60	35.00	35.00
WA-2PB-609	3,649.00	2,528.00	2,528.00
WA-2PB-806	954.66	7,214.83	954.66
WA-2PB-531	1,423.67		
WA-2PB-629	4,701.10	8,640.10	4,701.10

There has been paid to the receiver on account of all of these contracts the total sum of $5,713.53.

From the aforegoing it would appear that there is due a further payment of $3,143.23 on account of these contracts to be paid to the receiver. Accordingly, we request that these settlements be reviewed and the additional payment forwarded to us.

Very truly yours,

(S) A. J. BYRNE,
Secretary.

Exhibit C to amended petition

HINTON & HERON

WASHINGTON, 4, D. C., *March 11, 1944.*

The Honorable The Comptroller General of the United States, Washington 25, D. C.

Re: Claims No. 0980866–(1)–(2)–(4)
Certificates 0750427–429–439–964

SIR: This will serve to protest the settlement made in the above-entitled matters as a result of which $3,996.93 has been paid to the receiver appointed in the case of Klein v. Morgenthau, Jr.,
14 Civil Action No. 11643 in the District Court of the United States for the District of Columbia for the purpose of enforcing equitable rights of subrogation in favor of the contractor's surety. The Aetna Casualty and Surety Company, which was surety for the contractor on the five following contracts, paid numerous claims for labor and material furnished therefor. The amounts of the contract balances exclusive of the set-off made by your office in its recent settlement, together with the claims paid by The Aetna Casualty and Surety Company, are set out as follows:

		Contract balance	Claims paid
Whitewater	WA-2PB-597	$910.00	$648.00
Skowhegan	WA-2PB-702	391.60	35.00
Portland	WA-2PB-609	3,649.00	2,528.00
Gallup	WA-2PB-806	954.66	1,214.83
Denver	WA-2PB-531	1,423.67	....
Tulsa	WA-2PB-629	4,701.10	8,640.10

From the foregoing it would appear to follow upon the basis of the decision of the United States Court of Claims in Maryland Casualty Company v. The United States, decided January 3, 1944, that the surety would be entitled to receive through the medium of the receiver a total sum of $8,866.78. In other words, the surety would be entitled to reimbursement in full for claims paid under each contract to the extent that those contract balances were sufficient to permit such payment and the surety would be entitled to receive the payment free and clear of any independent set-offs existing in favor of the United States.

It is accordingly rquested that this matter be reviewed and that a further payment of $3,568.23 be made to the receiver on behalf of the surety.

Respectfully,

ALEXANDER M. HERON,
Attorney for The Aetna Casualty & Surety Company.

AMH : LF

15 *Exhibit D to Amended Petition*

COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON 25, *July 14, 1944.*

B-17988.

THE AETNA CASUALTY AND SURETY COMPANY,
c/o Hinton & Heron, Munsey Building,
Washington 4, D. C.

GENTLEMEN: Reference is made to your letter of March 15, 1944, relative to the settlements made by this office to the Munsey Trust Company, as receiver for the Federal Contracting Corporation, covering balances due under certain contracts entered into by that corporation with the Federal Works Agency, Public Buildings Administration. You protest the application of the amount of $6,731.50, otherwise due under said contracts, in partial liquidation of the contractor's indebtedness to the United States resulting from its default under contract No. WA 1pb 1916, dated Novem-

ber 16, 1940, alleging that since you have paid claims totaling $13,065.93 under certain payment bonds furnished by the contractor for the protection of materialmen and laborers, you are entitled by subrogation to reimbursement in full for the claims paid under each contract to the extent that each contract balance is sufficient to permit such payment; and upon the basis that such set-off action is precluded by the decision of the Court of Claims in the case of Maryland Casualty Co. v. United States, No. 45659, decided January 3, 1944 (100 C. Cls. 513), you claim that an additional payment of $3,568.23 is due and should be made to the receiver on your behalf.

16 At the outset, in considering the effect to be given to the holding of the Court of Claims, above referred to, it appears proper to repeat the sentiment often heretofore expressed that while the decisions of inferior courts are all given most careful study and consideration, especially where it appears that the merits of the legal principles involved have been presented to, and fully and faithfully considered by the court, nevertheless, it is the responsibility of this office, under the act of June 10, 1921, 42 Stat. 24, in the settlement and adjustment of claims, both for and against the United States, ultimately to determine the law for itself. 14 Comp. Gen. 648, 5 id. 720; 3 id. 479; id. 316.

This office does not consider the holding in the Maryland case a controlling precedent with respect to the right of subrogation of a surety to amounts otherwise due from the United States, as against the right of the Government to set off, out of such funds, moneys due from the surety's defaulting principal. The Government's right to set-off is a legal right. This is so, whether it be considered to derive from section 236, Revised Statutes, 31 U. S. C. 71 (see Taggart v. United States, 17 C. Cls. 322), or whether it be considered merely as a part of the general law of set-off. See Watkins v. United States, 9 Wall. 759, 764; United States v. Eckford, 6 id. 484, 488; Pennsylvania Railroad Co. v. Miller, 124 F. 2d 160, 162; The Gloria, 286 F. 188, 192; affirmed sub nom., United States v. The Thekla, 266 U. S. 328. When, therefore, a surety's equitable right of subrogation comes in conflict with the Government's legal right, the equitable right must yield. "Subrogation being the creature of equity * * * it will not be enforced * * * at the expense of a legal right." German Savings and Loan Society v. Tull, 136 F. 1, 6; Gray v. Jacobsen, 13 F. 2d 959; Federal Land Bank v. Smith, 129 Me. 233, 151, Atl. 420; Rand v. Cutler, 155 Mass. 451, 29 N. E. 1085.

Accordingly, and in the absence of a contrary ruling by the Supreme Court of the United States, the Maryland case may not be accepted to change or modify the long standing view of
17 this office that the right of the United States to have its debts first satisfied from funds earned by a contractor is paramount to the right of a surety asserting a loss in making payment of the claims of materialmen and laborers, and the action heretofore taken in the matter must be, and is, affirmed.

Respectfully.

(S) FRANK L. YATES,
Acting Comptroller General
of the United States.

Exhibit E to amended petition

Filed July 31, 1944.

In the District Court of the United States for the District of Columbia

Civil Action No. 11643

IRVING KLEIN, 875 LONGFELLOW AVENUE, NEW YORK, NEW YORK, PLAINTIFF

v.

HENRY MORGENTHAU, JR., SECRETARY OF THE TREASURY OF THE UNITED STATES, WASHINGTON, D. C., ET AL., DEFENDANTS

ORDER FOR DISTRIBUTION

Upon consideration of the report and supplemental report of the receiver herein and the consents of counsel hereto appended, it is by the Court this 31st day of July, 1944,

18 Ordered that the receiver, The Munsey Trust Company, be and it hereby is authorized to pay over to The Aetna Casualty & Surety Company $5,213.53 from the funds in its hands and to retain the sum of $500.00 to defray the expenses of the proceeding hereinafter authorized, and it is further

Ordered that the receiver be and it hereby is authorized and directed to institute a suit in the Court of Claims of the United States for the recovery of such other and further amounts as may be due under the contracts of the Federal Contracting Corpora-

tion described in the complaint and answers filed in this proceeding.

DAVID A. PINE,
Justice.

Consent:

HINTON & HERON,
By (S) ALEXANDER M. HERON,
Munsey Building, Washington, D. C.
Attorneys for Defendant,
The Aetna Casualty & Surety Company.
(S) WILLIAM T. HANNAN,
Attorney for Defendant,
Federal Contracting Corporation.
(S) VERNON LOWREY,
(S) HENRY S. GOODMAN,
Attorneys for Plaintiff.

19 *General traverse*

Filed February 21, 1946

And now comes the Attorney General, on behalf of the United States, and answering the amended petition of the claimant herein; denies each and every allegation therein contained; and asks judgement that the amended petition be dismissed.

JOHN F. SONNETT,
Assistant Attorney General.

R. B.
EEE.

Argument and submission of case

On June 5, 1946, the case was argued and submitted on merits by Mr. Alexander M. Heron for plaintiff, and by Mr. E. E. Ellison for defendant.

21 *Special findings of fact, conclusion of law and opinion of the court by Littleton, J.*

Filed October 7, 1946

Mr. Alexander M. Heron for plaintiff.
Messrs. Hinton & Heron were on the brief.
Mr. E. E. Ellison, with whom was Mr. Assistant Attorney General John F. Sonnett, for the defendant.
Mr. Robert Burstein was on the brief.

The plaintiff, as receiver appointed January 8, 1942, by the U. S. District Court for the District of Columbia to collect and

distribute certain funds representing balances due under certain contracts made and performed by the Federal Contracting Corporation with the United States, sues to recover $3,568.23 as a portion of the total of unpaid balances due under said contracts and to which The Aetna Casualty and Surety Company was entitled by reason of having paid, as a result of default in payment by the Federal Contracting Corporation, certain claims of laborers and materialmen under said contracts in the total amount of $13,065.93.

The defendant, in September 1943, applied as an offset the amount of $6,731.50 due it by the Federal Contracting Corporation, which was a claim not arising under any of the contracts under which plaintiff claims, against the total balances of $12,445.03 due under certain contracts and paid the receiver the difference of $5,713.53.

The question presented is whether the Government was entitled as against The Aetna Casualty and Surety Company to retain the total of the balances due on the contracts, to the extent of the $3,568.23 here in controversy.

22. *Special findings of fact*

1. Plaintiff is a District of Columbia banking corporation with its place of business in Washington, D. C. It was appointed receiver by the District Court of the United States for the District of Columbia in an action entitled Irving Klein v. Henry Morgenthau, Jr., Secretary of the Treasury of the United States et al., being Civil Action No. 11643 in that court, and brings this suit in its capacity as receiver.

2. The Federal Contracting Corporation, a New York corporation (hereinafter sometimes referred to as the "contractor"), entered into the following contracts with the United States through the Public Buildings Administration for the painting and repair of various public buildings of the defendant:

"Post Office, Denver, Colorado, Contract WA-2-pb-531, May 10, 1940.

"Post Office and Court House, Tulsa, Oklahoma, Contract WA-2-pb-629, July 6, 1940.

"Post Office, Whitewater, Wisconsin, Contract WA-2-pb-597, July 2, 1940.

"Customs House, Portland, Maine, Contract WA-2-pb-609, July 2, 1940.

"Post Office, Skowhegan, Maine, Contract WA-2-pb-702, July 16, 1940.

"Post Office, Gallup, New Mexico, Contract WA-2-pb-806, July 26, 1940."

At the time of the execution of the above contracts, the defendant required the contractor to give two bonds with surety in connection with each of them, one bond guaranteeing the performance of the contract and the other guaranteeing payment of materialmen and laborers. The latter type of bond contained the following provision:

"Now, therefore, If the principal shall promptly make payment to all persons supplying labor and material in the prosecution of the work provided for in said contract, and any and all duly authorized modifications of said contract that may hereafter be made, notice of which modifications to the surety being hereby waived, then this obligation to be void; otherwise to remain in full force and virtue."

The Aetna Casualty and Surety Company, a Connecticut corporation, was surety on each of the bonds.

3. At the time The Aetna Casualty and Surety Company became surety on the various bonds above mentioned the Fed-
23 eral Contracting Corporation entered into agreements with it in connection with each of the bonds so written whereby it agreed, among other things, that it would at all times indemnify and keep indemnified The Aetna Casualty and Surety Company and save it harmless from and against all damages, loss, costs, charges, and expenses which it might at any time sustain or incur by reason of its suretyship; and further agreed that the surety should be subrogated to all its rights, privileges, and properties in the contracts, and assigned and conveyed to the surety all of the monies and properties that might be due and payable to it upon its failure to pay bills incurred on the work when they became due and payable, agreeing that the proceeds of such payments should be the sole property of the surety to be credited by it upon any damage, charge, or expense incurred by it under its bonds. Each of the agreements was identical in terms except that it related only to the specific contract and bonds in connection with which it was made.

4. At the conclusion of the work under each of the contracts referred to in finding 2 and after the allowance of credit for payments made by the United States, there remained due and owing from the United States to the contractor under each of the contracts the following amounts:

Denver, Colorado, Contract WA-2-pb-531	$1,423.67
Tulsa, Oklahoma, Contract WA-2-pb-629	5,116.10
Whitewater, Wisconsin, Contract WA-2-pb-597	910.00
Portland, Maine, Contract WA-2-pb-600	3,649.00
Skowhegan, Maine, Contract WA-2-pb-702	391.60
Gallup, New Mexico, Contract WA-2-pb-806	954.66
Total	12,445.03

5. The contractor failed to make *payment to certain persons* who had furnished labor and material for use in the performance of the several contracts. The total amounts which the contractor failed to pay to such persons under each of the contracts are as follows:

Denver, Colorado, Contract WA-2-pb-531	None
Tulsa, Oklahoma, Contract WA-2-pb-629	$8,640.10
Whitewater, Wisconsin, Contract WA-2-pb-597	648.00
Portland, Maine, Contract WA-2-pb-699	2,528.00
Skowhegan, Maine, Contract WA-2-pb-702	35.00
Gallup, New Mexico, Contract WA-2-pb-806	1,214.83
Total	13,065.93

24 The Aetna Casualty and Surety Company, pursuant to demands by the furnishers of labor and material to these jobs and in accordance with information obtained as to its liability therefor, paid to such persons the total amount of the claims set forth above and in connection therewith each of those persons assigned to The Aetna Casualty and Surety Company his rights against the contractor.

6. On October 18, 1940, the Federal Contracting Corporation (the same corporation of that name previously referred to) submitted a bid in the sum of $20,743 for the painting of the United States Post Office at St. Louis, Missouri. The bid was accepted by the United States but the contractor failed to enter into the contract therefor in that it failed on November 16, 1940, to give the bond required in connection therewith. The United States thereupon caused the work to be performed at a cost of $27,867 which, together with the cost of readvertising the work in the amount of $22.50, created an indebtedness from the contractor to the United States in the amount of $7,146.50. After the application of its bid deposit of $415, there remained an indebtedness due from the contractor of $6,731.50.

7. Thereafter, on June 4, 1941, one Klein, a stockholder of the contractor, instituted an action in the District Court of the United States for the District of Columbia as described in finding 1, wherein he sued the Secretary of the Treasury, the Treasurer of the United States, the Commissioner of Public Buildings, the Federal Contracting Corporation, The Aetna Casualty and Surety Company, its surety, and other persons not concerned in these proceedings. The plaintiff in that action sought the appointment of a receiver for the amounts payable by the United States under the several contracts herein mentioned and the distribution thereof to the labor and material furnishers, or in the alternative to The Aetna Casualty and Surety Company, which latter by counterclaim and crossclaim joined in the same prayers. Thereafter the plaintiff was appointed receiver in that action and

directed by the order of its appointment to collect from the United States all monies due under those contracts and to hold the proceeds of such collection for the reimbursement of The Aetna
25 Casualty and Surety Company for expenditures made by it in its payment to persons furnishing labor and materials under the contracts. The same order dismissed the action as to the Secretary of the Treasury, the Treasurer of the United States, and the Commissioner of Public Buildings.

8. Pursuant to the order of its appointment, the plaintiff made demand upon the United States for the proceeds of the several contracts referred to in finding 2. The balances due from the United States on these contracts were in the total amount of $12,445.03, as shown in finding 4, and the net indebtedness due to the United States on account of the failure of the contractor to enter into a contract for the painting of the post office at St. Louis, Missouri, was in the amount shown in finding 6, namely $6,731.50.

The General Accounting Office made settlement of the above respective balances due from and to the United States in the following manner:

Contract	Balance due Contractor	Paid to Plaintiff	Withheld and applied to St. Louis contract indebtedness
Denver, Colorado	$1,423.67	None	$1,423.67
Tulsa, Oklahoma	5,116.10	$762.93	4,353.17
Whitewater, Wisconsin	910.00	910.00	None
Portland, Maine	3,649.00	3,649.00	None
Skowhegan, Maine	391.60	391.60	None
Gallup, New Mexico	954.66	None	954.66
Total	12,445.03	5,713.53	6,731.50

9. Plaintiff and The Aetna Casualty and Surety Company each protested the above action both before and at the time such action was taken. On July 14, 1944, the Comptroller General denied the protests and affirmed the action previously taken.

Plaintiff reported these facts to the United States District Court in the action in which it was appointed and upon consideration of that report the court issued the following order:

"Upon consideration of the report and supplemental report of the receiver herein and the consents of counsel hereto appended, it is by the Court this 31st day of July, 1944,

26 "Ordered that the receiver, The Munsey Trust Company, be and it hereby is authorized to pay over to The Aetna Casualty & Surety Company $5,213.53 from the funds in its hands and to retain the sum of $500.00 to defray the expenses of the proceeding hereinafter authorized, and it is further

"Ordered that the receiver be and it hereby is authorized and directed to institute a suit in the Court of Claims of the United States for the recovery of such other and further amounts as may be due under the contracts of the Federal Contracting Corporation described in the complaint and answers filed in this proceeding."

10. The following tabulation shows the balances due under each of the contracts as set out in finding 4, payments by the surety to the furnishers of labor and material under each contract, as shown in finding 5, and the amount now claimed by plaintiff in this proceeding:

	Balance Due Contractor	Payments by Surety	Amount Claimed by Plaintiff
Denver, Colorado, Contract WA-2-pb-531	$1,423.67	None	None
Tulsa, Oklahoma, Contract WA-2-pb-629	5,116.10	$8,640.10	$5,116.10
Whitewater, Wisconsin, Contract WA-2-pb-597	910.00	648.00	648.00
Portland, Maine, Contract WA-2-pb-609	3,649.00	2,528.00	2,528.00
Skowhegan, Maine, Contract WA-2-pb-702	391.60	35.00	35.00
Gallup, New Mexico, Contract WA-2-pb-806	954.66	1,214.33	954.66
Total	12,445.03	13,065.93	9,281.76
Less: Amounts previously paid plaintiff (see finding 8)			5,713.53
Total amount claimed by plaintiff			3,568.23

No payments have been made to the plaintiff, on account of the claims involved in this proceeding, other than herein described.

Conclusion of law

Upon the foregoing special findings of fact the court concludes as a matter of law that plaintiff is entitled to recover $3,568.23.

It is therefore ordered and adjudged that plaintiff is entitled to recover three thousand five hundred sixty-eight dollars and twenty-three cents ($3,568.23).

Opinion

Littleton, Judge, delivered the opinion of the court:

27 The question presented for determination in this case involves the legal and equitable rights of the Government and the surety on certain Government contracts who paid certain amounts for labor and material claims under its payment bonds given in connection with such contracts, in a certain portion of the total of the balances in the hands of the Government and remaining due under said contracts upon completion and acceptance of the work called for by such contracts.

In May and July, 1940, the Federal Contracting Corporation, a New York corporation, entered into six contracts with the United

States for the painting and repairing of certain Federal buildings, as set forth in finding 2. Under the terms of the bids of the Federal Contracting Corporation, the contracts, and the provisions of the act of August 24, 1935, 49 Stat. 793, payment and performance bonds were given by the contractor on each of which The Aetna Casualty and Surety Company was surety for the payment by the contractor to all persons supplying labor and material in the prosecution of the work provided for in said contracts and for the performance of work called for thereby. The contractor completed all six contracts and the work was duly accepted by defendant. The record does not show the exact dates on which these six contracts were completed, but they appear to have been completed during 1940. The Federal Contracting Corporation, however, as to five of the six contracts, defaulted under its payment bonds and under the contract, in failing to make payment of $13,065.93 to certain persons who had supplied and furnished labor and material for use in performance of the several contracts, as set forth in finding 5. Upon completion and acceptance there remained due from the Government a certain balance under each contract, which balances totaled $12,445.03. The Government had notice of the outstanding claims for labor and material. The persons supplying labor and material to the contractor made claims upon the Aetna Company, as surety on the payment bonds given under such contracts, and the Aetna Company after having verified the correctness of such claims made payment of the several claims due under five of the contracts in the total amount of $13,065.93 between April 7 and September 6, 1941—the last payment being in the amount of $35.00. The
28 greater part of the total amount of all claims for labor and material was paid on May 12, 1941. By reason of these payments by the Aetna Company it became subrogated to all the rights of the Federal Contracting Corporation, the laborers and materialmen, whose claims the Aetna Company paid, and of the Government so far as its rights under the contracts were concerned, in the balances due under the contracts in connection with which the surety made such payments, to the extent of such balances, and to the extent of payments made where such payments were less than the balances due under the particular contract. Prairie State Bank v. United States, 164 U. S. 227; U. S. Fidelity and Guaranty Company v. United States, 92 C. Cls. 144. The legal and equitable rights of the surety to the balance due under said contracts were superior to those of the United States as a general creditor of the defaulting contractor on a claim arising independently of any of the contracts in connection with which the surety made such pay-

ments under its bonds. Maryland Casualty Corporation, a corporation v. United States, 100 C. Cls. 513.

The balances, totaling $12,445.03, remaining in the hands of the Government and due under the six completed contracts were not paid, however, to the surety, as claimed by it, to the extent of $9,281.76, finding 10, but only $5,713.53 was paid. The difference between the total of the labor and material claims paid by the Aetna Company, and applicable to the balances remaining due under five of the contracts in the total amount of $9,281.76, and the amount of $5,713.53 paid to the surety by defendant, is $3,568.23, which amount the plaintiff, on behalf of the surety, seeks to recover herein.

The refusal of the defendant, to pay the Aetna Company $9,281.76 on its claim, and to pay the plaintiff, after it was appointed receiver, the entire balances totaling $12,445.03, was due to the fact that the Federal Contracting Corporation had become indebted to the Government for $6,731.50 on an independent transaction not arising under any of the contracts in connection with which the surety had made payments under its payment bonds, and the claim of the Government that its right of offset was superior to any legal or equitable right which the Aetna Company, as surety, had under the contracts and the payment bonds in the balances remaining due under those contracts.

29 The offset made by the Comptroller General was the result of a settlement and adjustment made by him under authority of section 236 of the Revised Statutes, 31 U. S. Code section 71, to satisfy a debt due by the Federal Contracting Corporation to the Government which arose in the manner hereinbelow set forth.

On October 18, 1940, the Federal Contracting Corporation, pursuant to an advertisement and invitation for bids by defendant, submitted a bid in the sum of $20,743.00 for painting the Post Office building at St. Louis, Mo. This bid was accepted by defendant, and the contractor signed the standard form of Government contract which, in its bid, it had agreed to execute. However, the contractor was unable to furnish surety bonds for performance and for payment to all persons supplying labor and material in prosecution of the work provided for in the contract. Thereupon the United States refused to award the contract to the Federal Contracting Corporation. It readvertised and relet the work to be performed to the lowest bidder at $27,867.00, which, together with the cost of readvertising in the amount of $22.50, created an indebtedness of $7,146.50 from the Federal Contracting Corporation to the United States. After the application of the cash deposit of $415.00 made by the Federal Contracting Com-

pany with its bid, there remained an indebtedness due from the contractor of $6,731.50.

Soon after its appointment as receiver, as set forth in finding 7, plaintiff on January 10, 1942, formally notified defendant of its appointment and demanded payment to it by the United States of the balances due under the contracts hereinbefore mentioned, and requested that settlement under each of the contracts be made and that the balances due be paid over to it. Instead of doing this, the Comptroller General on September 27, 1943, made the offset of $6,731.50, as above mentioned, and paid the balance of $5,713.53 to plaintiff. Plaintiff protested this adjustment and settlement to the extent of $3,568.23, and on March 15, 1944, after the decision of this court in Maryland Casualty Company v. United States, supra, further protested the action of the Comptroller General and requested reconsideration and payment of the additional amount of $3,568.23 under authority of the
30 Maryland Casualty Company decision. The Comptroller General refused to modify the settlement which he had made and advised plaintiff of his reasons therefor as follows:

"At the outset, in considering the effect to be given to the holding of the Court of Claims, above referred to, it appears proper to repeat the sentiment often heretofore expressed that while the decisions of inferior courts are all given most careful study and consideration, especially where it appears that the merits of the legal principles involved have been presented to, and fully and faithfully considered by the court, nevertheless, it is the responsibility of this office, under the act of June 10, 1921, 42 Stat. 24, in the settlement and adjustment of claims, both for and against the United States, ultimately to determine the law for itself. 14 Comp. Gen. 648, 5 id. 720; 3 id. 479; id. 316.

"This office does not consider the holding in the Maryland case a controlling precedent with respect to the right of subrogation of a surety to amounts otherwise due from the United States, as against the right of the Government to set off, out of such funds, moneys due from the surety's defaulting principal. The Government's right of set-off is a legal right. This is so whether it be considered to derive from section 236, Revised Statutes, 31 U. S. C. 71 (see Taggart v. United States, 17 C. Cls. 322), or whether it be considered merely as a part of the general law of set-off. See Watkins v. United States, 9 Wall. 759, 765; United States v. Eckford, 6 id. 484, 488; Pennsylvania Railroad Co. v. Miller, 124 F. 2d 160, 162; The Gloria, 286 F. 188, 192, affirmed sub nom., United States v. The Thekla, 266 U. S. 328. When, therefore, a surety's equitable right of subrogation comes in conflict with the Government's legal right, the equitable right must yield. Subrogation

being the creature of equity * * * it will not be enforced * * * at the expense of a legal right.' German Savings and Loan Society v. Tull, 136 F. 1, 6; Gray v. Jacobsen, 13 F. 2d. 959; Federal Land Bank v. Smith, 129 Me. 233, 151 Atl. 420; Rand v. Cutler, 155 Mass. 451, 29 N. E. 1085.

"Accordingly, and in the absence of a contrary ruling by the Supreme Court of the United States, the Maryland case may not be accepted to change or modify the long standing view of this office that the right of the United States to have its debts first satisfied from funds earned by a contractor is paramount to the
31 right of a surety asserting a loss in making payment of the claims of materialmen and laborers, and the action heretofore taken in the matter must be, and is, affirmed."

In its brief and argument in this case the defendant seeks to sustain the position taken by the Comptroller General and has reargued the question decided by this court in the Maryland Casualty Company case. We find no reason for modifying our opinion in that case.

In Moran v. Guardian Casualty Company, 76 Fed. (2d) 438, the Circuit Court of Appeals for the District of Columbia said:

"In Lyttle v. National Surety Co., 43 App. D. C. 136, we held, in a case involving the rights of a surety who had paid the claims of laborers and materialmen under a bond similar in all respects to the one here, that the surety was entitled to be subrogated not only to the rights of the contractor, but also to the rights of the United States under the contract. The former rights are here and generally bootless, but the latter include every right which the United States were capable of asserting against contractor had the surety not satisfied the obligations of the contract. We likewise held that this equitable right or lien existed in favor of the surety from the date of the bond. We said as much again in the recent case of Philadelphia Bank v. McKinlay, Trustee, 63 App. D. C. 296, 72 F. (2d) 89. In these circumstances, we have no doubt that appellee, as surety, is entitled to priority, notwithstanding the subsequent assignment of the fund by contractor; and this is true even though the assignment was given for an advancement of money used in the prosecution of the work. Prairie State Nat. Bank v. United States, 164 U. S. 227, 17 S. Ct. 142, 41 L. Ed. 412. And see, also, Exchange State Bank v. Fed. Surety Co. (C. C. A.) 28 F. (2d) 485–488; where the cases are collected at great length. * * *

"In that case [of Moran lending money to the contractor], he is presumed to act with full knowledge of the rights of the surety, and these rights, as we have seen, include a lien in favor of the surety from the date of the execution of the bond, for the surety

by the terms of the bond is bound to the payment of all claims growing out of the performance of the contract. And this, of itself, creates the equitable right of subrogation. The subsequent assignment, therefore, was wholly insufficient to create a
32 superior lien to the then existing lien of the surety (appellee). These principles are so elementary that further discussion would obviously be out of order."

In Farmers' Bank v. Hayes, et al., 58 Fed. (2d) 34, 37, the court said:

"This is on the principle that a surety who gives bond to the owner to insure performance of a building contract by the contractor is subrogated to the rights of the owner in the precentage which the owner retains as security for the performance of the contract, when upon default by the contractor the surety performs, as in Prairie State National Bank case, or on the principle that when the contractor performs his obligation to the owner, but fails to pay labor and materialmen, and the surety is obliged to do so under his bond, the surety is subrogated to liens of laborers and materialmen upon the fund reserved by the owner, as in the Henningsen case. The distinction between the Prairie Bank and the Henningsen cases is pointed out by this Court in Belknap Hardware & Manufacturing Company v. Ohio River Contract Company, 271 Fed. 144. But, whether in the instant case the surety's rights arise out of subrogation to the rights of the Board of Trust or of the equitable liens of the laborers and materialmen, the result is the same. In either case the equitable rights of the surety become fixed as of the date of the bond, and are superior to those of any holder of an after acquired lien. Whether the lien of the surety extends only to the reserved percentage under the contract, or also to sums earned under the contract, and retained by the owner, is a question which has frequently been raised. We think it is now settled that it extends to both. * * *."

In United States Fidelity and Guaranty Company v. Sweeney, 80 Fed. (2d) 235, the court said:

"* * * Laborers and materialmen, however, have an equitable right to payment from funds due a contractor on a public improvement in preference to general creditors. Belknap Hardware & Manufacturing Co. v. Ohio River Contract Co. (C. C. A. 6), 271 Fed. 144. The statutory requirement of a bond to protect them is not inconsistent with such equitable rights. American Surety Co. v. Westinghouse Elec. Mfg. Co. (C. C. A. 5), 75 Fed. (2d) 377. There is a recognized equitable right of unpaid furnishers of labor or materials to such part of the contract price as may remain in the possession of the Government after
33 the completion of the work by the contractor. Riverview State Bank v. Wentz (C. C. A. 8), 34 Fed. (2d) 419; Hen-

ningsen v. United States Fidelity and Guaranty Co., 208 U. S. 404, 28 S. Ct. 389, 52 L. Ed. 547; Farmers' Bank v. Hayes (C. C. A. 6), 58 Fed. (2d) 34; American Surety Co. v. Westinghouse Elec. Mfg Co. (C. C. A. 5), 75 Fed. (2d) 377.

"Appellant was bound by contract to pay the claims for labor and material, and upon paying these claims it was entitled to be subrogated to the superior equities of the laborers and materialmen, and when payment was made its rights related back to the time of making the contracts. Prairie State Bank v. United States, 164 U. S. 227, 17 S. Ct. 142, 145, 41 L. Ed. 412; Henningsen v. United States Fidelity and Guaranty Co., 208 U. S. 404, 28 S. Ct. 389, 52 L. Ed. 547; London and Lancashire Indemnity Co. v. Endres (C. C. A. 8), 290 Fed. 98; in re: Scofield Co. (C. C. A. 2), 215 Fed. 45; Farmers' Bank v. Hayes (C. C. A. 6), 58 Fed. (2d) 34."

In Morgenthau, et al. v. Fidelity & Deposit Company of Maryland, 94 Fed. (2d) 632, the court said:

"The surety claims an equitable lien on the fund grounded upon the assignment made by the contractor as consideration for the execution of the bond. It likewise claims the fund by subrogation on account of the money paid out by it to complete the contract and discharge the claim.

We are of opinion that the surety's position in this latter respect is sustained by reason and authority. Its bond was that the contractor would complete the contract and pay promptly all persons furnishing labor and materials in connection therewith. The contractor failed to carry out his contract, and the surety advanced the money, and in addition paid all the labor and material bills still unpaid. It did this, not as a volunteer, but by reason of its contract entered into before the commencement of the work. Its advance to the contractor and its payment to the laborers and materialmen released the contractor from his obligations under the contract and, as the Supreme Court said in Henningsen v. U. S. F. and G. Company, 208 U. S. 404, * * * likewise released the Government from all equitable obligations to see that the laborers and supplymen were paid. It thereby became subrogated to the equity of the United States. Its action created in itself an equitable right which entitled it to demand and receive the balance due from the United States, and this equitable right, as the Supreme
34 Court said in Prairie State Bank v. U. S., 164 U. S. 227, * * * arose from and related back to the date of the original contract of suretyship. * * *."

Aside from the question of whether persons who supply labor and material for use on work under a public contract, or the surety who pays their claims, acquires an equitable lien on the balance

due under the contract upon completion thereof, including the retained percentage, we are of opinion under the long line of decisions involving the rights of laborers and materialmen, and sureties, that the equities of such laborers and materialmen, and of the surety who pays their claim, in any balance remaining due under the contract on which the contractor defaulted in payment, are clearly superior to the rights of general creditors, including the Government. When the surety pays labor and material claims upon which the contractor defaulted, the surety's rights relate back to the date of the bond, which, in this case, was prior to the date on which the Federal Contracting Corporation became indebted to the United States on November 16, 1940, when it failed to furnish a bond under a contract with the defendant pursuant to its bid. The reason for the rule that such claims are superior to those of general creditors is that the persons who supply labor and material, although having no legal cause of action against the United States, because not in contractual relation with the United States, in effect furnished the Government with a part of what its contract called for and, having received the benefit of such labor and material, the Government is not entitled, as a general creditor, to retain the balance due under the contract and apply it in satisfaction of an independent claim against the defaulting contractor.

In Maryland Casualty Co. v. United States, supra, we held that the contract, the bond, and the transaction as a whole should be construed "as implying a promise on the part of the Government to the surety that it will not so settle the account of the contractor as to leave the surety in the position of paying the contractor's taxes."

We think it is immaterial that the laborers and materialmen, not being in contractual relation with the United States, and, by reason of the provision in the contract that all material
35 and work covered by partial payments made should thereupon become the sole property of the Government prevented them from having a lien upon the structure, had no legally enforceable claim against the United States for the balance due under the contract. The equitable interests of laborers and materialmen and the surety on the payment bond given under the contract and the requirements of the act of Congress (40 U. S. C. 270 (a), (b), (c), and the earlier acts of August 13, 1894, 28 Stat. 278, and February 24, 1905, 33 Stat. 811) have been firmly established without exception by a long line of decisions. These decisions hold, first, that the priority or preference of the United States in payment of its debts in the case of insolvency, of its debtor is inferior to an existing equitable lien; second, that sup-

pliers of labor and material, as well as a surety who has paid their claims, have a lien upon a public structure where the contract did not vest in the United States title to the work and the material as the work progressed and progress payments were made (United States v. Ansonia Brass & Copper Company, 218 U. S. 453); third, that the equities of laborers and materialmen, and sureties upon the bond, in any balance remaining due under the contract, including retained percentages, are superior to the rights and claims of general creditors and assignees of the defaulting contractor.

With respect to the superior equities of the laborers and materialmen and the surety upon a payment bond, the court, in Henningsen v. United States Fidelity and Guaranty Company of Baltimore, Maryland, supra, said:

"The Guaranty Company was surety on that contract [for the construction of the public work]. Its stipulation was not merely that the contractor should construct the buildings, but that he should pay promptly and in full all persons supplying labor and material in the prosecution of the work contracted for. He did not make this payment, and the Guaranty Company, as surety, was compelled to and did make the payment. Is its equity superior to that of one who simply loaned money to the contractor to be by him used as he saw fit, either in the performance of his building contract or in any other way? We think it is. It paid the laborers and materialmen, and thus released the contractor from his obligations to them; and to the same extent released the Government
36 from all equitable obligations to see that the laborers and supply men were paid. It did this not as a volunteer but by reason of contract obligations entered into before the commencement of the work [citing cases]."

With respect to any balance, including reserved percentage under a contract where the contractor has defaulted upon the payment bond, the effect of the statute requiring such bond, the contract and the bond itself, when read together, is to make the equity of laborers and materialmen and the surety superior to the claims of general creditors and subsequent assignees of the defaulting contractor, and out of this equity there grows a right or interest of the laborers and materialmen and the surety in the retained percentage which, even if not a lien in the strict and proper sense, brings kindred consequences along with it, and a court applying equitable principles in such case will come to the aid of one whose equity is superior. In the case at bar the United States was, upon completion of the contracts by the Federal Contracting Corporation, a stakeholder of the balance due thereunder in the total amount of $12,445.03 for payment or distribution thereof to the persons entitled thereto. Although the Government was not legally

liable to the suppliers for labor and material to the defaulting contractor, because they were not in contract relation with it and had no established lien upon the structure, or upon the balances due under the contracts, nevertheless, as held in Henningsen v. U. S. Fidelity & Guaranty Co., supra, certain equitable obligations rested upon the Government to see that the laborers and supply men were paid to the extent of any amount, or balance, remaining due under the contracts. The surety on the defaulting contractor's payment bond was in contractual relation with the United States, and when it paid the claims of the laborers and supply men against the Federal Contracting Corporation it was subrogated to all the equity in favor of laborers and supply men. The right of the surety to make demand and to receive any balances due under the contracts, to the extent of such balances or to the extent of the payments so made, as against all general creditors of the defaulting contractor related back to the date of the payment bond which, in this case, was July 1940.

37 In addition to being a stakeholder of the balances due under the contracts involved in this case, the United States in November 1940 became a general creditor of the Federal Contracting Corporation by reason of the failure of that corporation to enter into another contract with the Government pursuant to its accepted bid. It was therefore a general creditor of the defaulting contractor on a claim not arising under the contracts in respect of which it held certain unpaid balances. In these circumstances the claim of The Aetna Casualty and Surety Company and of the plaintiff, as receiver for the balances due under the completed contracts with the Federal Contracting Company to the extent of $9,281.76 (finding 10), was and is superior to the claim of the United States, as a general creditor on an independent claim.

The defendant argues, however, that the legal right of the Government to satisfy its independent claim against the defaulting contractor by the offset made September 27, 1943, was superior to and superseded any legal or equitable claim which laborers and materialmen, or the surety, had with respect to the contract balances in its hands, since the Government had no obligation to pay debts of the defaulting contractor to laborers and materialmen, and since the amount due from the Government under the completed contracts was not a trust fund for the satisfaction of such claims. This argument as to the superior right of the Government in the contract balances is based upon the general right of the Government, which is the common right of any creditor, to apply the unappropriated monies of its debter in its hands to the extinguishment of the debt due the Government and, also upon

the provisions of section 236 R. S., as amended (31 U. S. C., sec. 71).[1]

Neither the general right of the Government to make offsets nor the provisions of sec. 236 R. S. give to the claim of the Government any greater equitable force and effect than would attach to the claim of any general creditor to the contract balances
38 in the Government's hands. The provision for administrative settlement and adjustment of claims and demands by the Government, or against it, and all accounts with which the Government is concerned, either as debtor or creditor amounted to no more than the statutory declaration of a right which the Government would otherwise have, and the term "settled and adjusted" was used to describe administrative determination of the amount due, either by or to the Government. The statutory provision for administrative settlement and adjustment of accounts has been in effect in substances since the enactment of section 3 of the act of September 2, 1789, 1 Stat. 65, establishing the Treasury Department. This statutory provision as to administrative settlement and adjustment of claims and accounts, with which the Government is concerned, has never been held by the courts to create a preference or priority in favor of the United States in respect of any debt that might be due it. This matter is taken care of by other statutory provisions, such as R. S. 3466 and the bankruptcy statutes. The statutory provision for administrative settlement and adjustment of claims and accounts is directory and was enacted for the purpose of designating the official who should be charged with that administrative duty and responsibility. "Whether the amount so fixed is due, in law and fact, undoubtedly remains a question to be adjudicated, if properly raised in judicial proceedings. * * *." Illinois Surety Company in v. United States to the Use of Peeler et al., 240 U. S. 214, 221.

This court has jurisdiction and authority under section 145 of the Judicial Code, 28 U. S. Code 250 (1), to apply equitable principles where applicable in suits against the United States for a money judgment. This is such a case, since the claim here made by plaintiff, as receiver, arose under contracts with the United States, and the statute expressly provides that this court shall have jurisdiction to hear and determine all such claims "in respect of which claims the party would be entitled to redress against the United States, either in a court of law, equity, or admiralty, if the

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[1] All claims and demands whatever by the Government of the United States or against it, and all accounts whatever with which the Government of the United States is concerned, either as debtor or as creditor, shall be settled and adjusted in the General Accounting Office.

United States were suable." Cf. Seminole Nation v. United States, 316 U. S. 286, 294–300.

For the reason stated and in view of the authorities cited, we hold that the right of surety and of plaintiff, as receiver,
39 which is in the nature of an equitable lien, to have the contract balances in the Government's hands applied in satisfaction of payments made by the surety to laborers and materialmen cannot be displaced by the Government's general right of offset.

Plaintiff is entitled to recover $3,568.23 and judgment will be accordingly entered in its favor for that amount. It is so ordered.

Jones, Judge; Whitaker, Judge; and Whaley, Chief Justice, concur.

Madden, Judge, took no part in the decision of this case.

41

Judgment of the court

Oct. 7, 1946

Upon the special findings of fact, which are made a part of the judgment herein, the court decides as a conclusion of law, that the plaintiff is entitled to recover $3,568.23.

It is therefore ordered and adjudged that the plaintiff recover of and from the United States the sum of three thousand five hundred sixty-eight dollars and twenty-three ($3,568.23).

43 [*Duly sworn to by jurat omitted in printing.*]

U. S. GOVERNMENT PRINTING OFFICE: 1947

Supreme Court of the United States

29

No. 847, October Term, 1946

Order allowing certiorari

Filed March 3, 1947

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

No. 847

In the Supreme Court of the United States

October Term, 1946

The United States, petitioner

v.

The Munsey Trust Company of Washington, D. C., receiver

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

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In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 847

THE UNITED STATES, PETITIONER

v.

THE MUNSEY TRUST COMPANY OF WASHINGTON, D. C., RECEIVER

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

The Acting Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Claims of the United States entered in the above-entitled case on October 7, 1946.

OPINION BELOW

The opinion of the Court of Claims (R. 17-28) is reported at 67 F. Supp. 976.

JURISDICTION

The judgment of the Court of Claims was entered on October 7, 1946 (R. 28). The juris-

diction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925, as amended.

QUESTION PRESENTED

Whether the United States may set off an indebtedness due from a contractor on an independent transaction against a balance due to the contractor on certain construction contracts where a surety under payment bonds has satisfied unpaid material and labor claims under those contracts.

STATUTES INVOLVED

The pertinent portions of the statutes involved are set forth in Appendix A, *infra*, pp. 14-20.

STATEMENT

The facts as found by the Court of Claims may be briefly summarized as follows:

The Federal Contracting Corporation, a New York corporation (contractor), between May 10 and July 26, 1940, entered into six contracts with the United States, through the Public Buildings Administration, for the painting and repair of various buildings belonging to petitioner (R. 17-18). The Aetna Casualty and Surety Company (surety) furnished the two bonds required of the contractor under each of the contracts, one guaranteeing the performance of the contract and the other guaranteeing payment of materialmen and

laborers (R. 18).[1] In connection with these bonds the contractor entered into "Agreements of Indemnity" with the surety whereby it agreed that the surety should be subrogated to all its rights, privileges, and properties in the contracts, and assigned to the surety all moneys that might be due and payable to it on its failure to pay bills incurred in the work (R. 14). The contractor failed to make payments, totaling $13,065.93, to persons who had furnished labor and material for use in the performance of five of the contracts. The surety made these payments in accordance with its obligation under the payment bonds (R. 18). Upon completion of the contracts by the contractor and after allowance of credit for payments made, there remained due and owing from the United States to the contractor a total of $12,445.03 on account of the six contracts (R. 18).

On October 18, 1940, the contractor submitted a bid to the United States for the painting of the United States Post Office at St. Louis, Missouri. The bid was accepted but the contractor failed to enter into the contract therefor and failed to give the bond required in connection therewith. Thereupon, the work was relet and performed at a cost of $7,146.50 over and above the contractor's bid. After the application of the bid deposit of

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[1] These bonds are required by the Miller Act, 49 Stat. 793, 40 U. S. C. 270a *et seq.*, Appendix A, *infra*, pp. (14–17). The Miller Act replaced the Heard Act, 33 Stat. 811, 40 U. S. C. 270, Appendix A, *infra*, pp. 18–20.

$415 there remained an indebtedness due to the United States from the contractor of $6,731.50 (R. 19–20).

On June 4, 1941, one Klein, a stockholder of the contractor, instituted an action entitled "*Klein* v. *Henry Morgenthau, Jr., Secretary of the Treasury of the United States et al.,*" Civil Action No. 11643, in the District Court of the United States for the District of Columbia, seeking the appointment of a special receiver [2] for the amounts due under the above-mentioned six contracts, and the distribution of those amounts to the laborers and materialmen or, in the alternative, to the surety, who, by counter claim and cross claims, joined in the same prayers. Subsequently the Munsey Trust Company, a District of Columbia banking corporation was appointed receiver and directed by the order of its appointment to collect from the United States all moneys due under the six contracts, and to hold the proceeds of such collection for the reimbursement of the surety for expenditures made by it in its payment to furnishers of labor and material under the six contracts. The action was dismissed as against the Secretary of the Treasury, the Treasurer of the United States and the Commissioner of the Public Buildings, who had been named as defendants.

[2] In accordance with the established procedure in the courts of the District of Columbia, such receivership is for the purpose of taking possession of a fund or property and preventing its loss or dissipation. It does not necessarily involve insolvency, and in the action in the district court, no claim of insolvency was made by either party.

Pursuant to the order of its appointment, respondent made demand upon the United States for the proceeds of the balances due under the several contracts. The General Accounting Office paid to respondent the balances due under the six contracts except for the amount of $6,731.50 which was applied in liquidation of the contractor's indebtedness to the United States by reason of its default under the St. Louis Post Office contract. Respondent and the surety each protested this set-off, but the Comptroller General affirmed the action taken in the matter. Respondent reported these facts to the United States District Court in the action in which it was appointed receiver and was authorized and directed to institute suit in the Court of Claims for the recovery of such further amounts as may be due under the six contracts.

In the Court of Claims, respondent, who had received $5,713.53, claimed that it was entitled to a further balance of $3,568.23 for the benefit of the surety, on the ground that the surety was entitled to a total of $9,281.76 representing the payments to laborers and materialmen made by it under each contract to the extent that each contract balance was sufficient to permit such payment.[3]

[3] Finding No. 10 of the court below (R. 17) shows the balances due under each contract, payments by the surety to the furnishers of labor and material under each contract, and the amounts claimed by respondent under each contract.

The court below held that when the surety paid the claims of the laborers and materialmen, it was subrogated to all the equities in their favor, which although "not a lien in the strict and proper sense, brings kindred consequences along with it" (R. 25); that "neither the general right of the Government to make offsets nor the provisions of sec. 236 R. S. give to the claim of the Government any greater equitable force and effect than would attach to the claim of any general creditor to the contract balances in the Government's hands" (R. 27); and therefore that "the right of the surety and of plaintiff, as receiver, which is in the nature of an equitable lien, to have the contract balances in the Government's hands applied in satisfaction of payments made by the surety to laborers and materialmen cannot be displaced by the Government's general right of offset" (R. 28).

SPECIFICATION OF ERRORS TO BE URGED

The Court of Claims erred:

1. In holding that the rights of the surety upon paying the claims of the materialmen and laborers, although "not a lien in the strict and proper sense, brings kindred consequences along with it."

2. In holding that upon paying the claims of contractor's materialmen and laborers, the rights of the surety to the fund in the hands of the Govment were superior to the right of the Government to a setoff.

3. In holding that the United States, in respect of the retained fund, was merely a stakeholder.

4. In holding that despite the general right of the Government to make offsets, its claim to the retained fund was no better than that of a general creditor of the contractor.

5. In holding that despite the provisions of Rev. Stat. 236, the Government's claim to the retained fund was no better than that of a general creditor of the contractor.

6. In holding that the United States could not set off its claim against the contractor against the balance due to him because of the equities of the surety.

7. In entering judgment for the respondent.

REASONS FOR GRANTING THE WRIT

1. The holding of the Court of Claims that a surety who has paid claims of materialmen and laborers against his principal has priority to the contract balance in the hands of the Government as against the Government's right to set off the contractor's liability to it against such balance in effect vests in the surety rights superior to those to whom he was subrogated, and ignores the basic principle that "The party for whose benefit the doctrine of subrogation is exercised can acquire no greater rights than those of the party for whom he is substituted." *Globe Indemnity Co.* v. *United States*, 84 C. Cls. 587,

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595, certiorari denied, 302 U. S. 707; *Southern Surety Co.* v. *United States,* 75 C. Cls. 47; *Alexander* v. *Young,* 65 F. (2d) 752, 757 (C. C. A. 10); *Swarts* v. *Siegel,* 117 Fed. 13, 15, 16 (C. C. A. 8); Sheldon *Subrogation* (2d Ed.), §§ 1, 6.

In the present case, the surety, upon paying the claims of the contractor's laborers and materialmen, apparently became subrogated to the rights of both the contractor and the laborers and materialmen. If the contractor himself had discharged these liabilities, he clearly would be unable to oppose the Governments setoff since, in these circumstances, the Government unquestionably has the right, and the General Accounting Office the duty, to make such setoff both under the general law and under Rev. Stat. 236, 31 U. S. C. 71, Appendix A, *infra,* p. 14. *Barry* v. *United States,* 229 U. S. 47, 53; *Gratiot* v. *United States,* 15 Pet. 336; *McKnight* v. *United States,* 13 C. Cls. 292, affirmed 98 U. S. 179; *Taggert* v. *United States,* 17 C. Cls. 322, 327; *American Sanitary Rug Co.* v. *United States,* 84 C. Cls. 417; *John P. Squire Co.* v. *United States,* 90 C. Cls. 276. Nor does subrogation to the rights of the materialmen and laborers place the surety in such a preferred position. Even in the absence of a bond securing payment of their claims, unpaid materialmen and laborers on a public contract would have no legally binding claim against the United States. *Kellogg* v. *United*

States, 7 Wall. 361; *H. Herfurth, Jr., Inc.* v. *United States*, 89 C. Cls. 122. At most, the United States had the moral obligation to see that the materialmen and laborers were paid. Cf. *Henningsen v. U. S. Fidelity & Guaranty Co.*, 208 U. S. 404; *California Bank* v. *U. S. Fidelity & Guaranty Co.*, 129 F. (2d) 751, 754 (C. C. A. 9).

Contrary to the finding of the court below, the effect of the Miller Act, Appendix A, *infra*, pp. 14–17, and its predecessor Heard Act, Appendix A, *infra*, pp. 18–20, and the bonds required thereunder, could not be to give the surety a right or interest which "if not a lien in the strict and proper sense brings kindred results along with it" (R. 25). Such finding is tantamount to holding that the surety did obtain an equitable lien, a conclusion which the court below has admitted is improper. See *Seaboard Surety Co.* v. *United States*, 67 F. Supp. 969, 972 (C. Cls.), and cases there cited. As a matter of fact, the purpose of these Acts was to provide protection for such materialmen and laborers by creating a new cause of action for these creditors against the surety. *MacEvoy Co.* v. *United States*, 322 U. S. 102; *Texas Cement Co.* v. *McCord*, 233 U. S. 157; *Hill* v. *American Surety Co.*, 200 U. S. 197; *United States Fidelity and Guaranty Co.* v. *United States*, 191 U. S. 416. It would be anomalous if the surety should have rights which are denied to the class for whose protection the bond is required.

The court below improperly treated the United States as the holder of the fund separable from its creditor relationship to the contractor, and based its finding that the surety had priority to the retained fund on cases such as *Prairie State Bank* v. *United States*, 164 U. S. 227.[4] In that case, the question was whether a bank to which the contractor had assigned sums due under a building contract or the surety on the performance bond who had taken over and completed the work after the contractor's default was entitled to the money which the Government retained as a special fund to assure performance. The Government was solely a stakeholder, and made no claim to the fund. In the present case, the United States is not claiming priority over the surety

[4] The court below quoted at length from *Henningsen* v. *United States Fidelity & Guaranty Co.*, 208 U. S. 404; *Moran* v. *Guardian Casualty Co.*, 76 F. (2d) 438 (App. D. C.); *Farmers' Bank* v. *Hayes*, 58 F. (2d) 34 (C. C. A. 6); *United States Fidelity and Guaranty Co.* v. *Sweeney*, 80 F. (2d) 235 (C. C. A. 8); *Morgenthau* v. *Fidelity & Deposit Co.*, 94 F. (2d) 632 (App. D. C.). All these cases involved substantially the same situation as the *Prairie Bank* case, and were decided ultimately on the authority of that case. The court below also cited *United States Fidelity and Guaranty Co.* v. *United States*, 92 C. Cls. 144 (R. 18). In that case the surety on a performance bond elected to complete a contract after the contractor's default and entered into a supplemental agreement with the United States providing that any amounts retained from payments made to the original contractor should be paid to the surety upon completion of the work. In accordance with the terms of the supplemental contract, the Court of Claims held that the surety was entitled to the retained amounts.

to a fund in the hands of a third person, but asserts that under the general law and statutes, it has the right to set off the debt of the contractor to it against its debt to the contractor. Moreover, there is not here present, as in the *Prairie Bank* case, a right on the part of the surety to be subrogated to the rights of the United States against the retained funds. First, the obligation discharged—the payment of claims of laborers and materialmen—was not that of the United States. And, in the second place, all claims of the United States had not been satisfied. Cf. *United States* v. *National Surety Co.*, 254 U. S. 73. Since the cases relied on by the court below do not involve any claim of the United States to setoff, these cases, we submit, are inapplicable.

Maryland Casualty Co. v. *United States*, 100 C. Cls. 513, is the only case where the precise question here involved has been decided.[5] The basis of the court's decision in that case was a promise by the Government to the surety, implied from

[5] *Dewey Schmoll* v. *United States*, 105 C. Cls. 415, certiorari denied October 14, 1946, and *Seaboard Surety Co.* v. *United States*, 67 F. Supp. 969 (C. Cls.), involved the additional fact of an assignment for the benefit of creditors. In those cases, the Court of Claims properly held that in those circumstances Rev. Stat. 3466, Appendix B, *infra*, p. 21, accorded the Government priority over the surety. The United States opposed the granting of a writ of certiorari in the *Dewey Schmoll* case on the ground that because of Rev. Stat. 3466 the question there presented was very narrow and correctly decided by the Court of Claims, but that statute is not involved in the present case.

the bond and transaction as a whole, that it would not so settle the accounts as to leave the surety in the position of paying the contractor's debts (100 C. Cls. at 520–521). Here again the decision of the court below was erroneous, since the Government's right of setoff has long been established by judicial decisions and statute, and is an old and well-recognized practice in the General Accounting Office. See cases cited, *supra*, p. 8. No good reason appeared why the surety should not have been charged with knowledge of that right and practice. *Dewey Schmoll* v. *United States*, 105 C. Cls. 415, certiorari denied October 14, 1946; *Von Hoffman* v. *City of Quincy*, 4 Wall. 535, 550; cf. *Hill* v. *American Surety Co.*, 200 U. S. 197, 203, 205.

2. The question presented in this case is one of substantial importance meriting review by this Court. Prior to the *Maryland Casualty* case, the General Accounting Office, the agency charged with the administration of Rev. Stat. 236, had consistently set off mutual claims in such situations, which arise frequently. If not reversed, the instant case, together with *Maryland Casualty* case, will create serious administrative problems for the General Accounting Office. Where the contractor is actually insolvent, that agency will be forced to initiate innumerable receivership proceedings for the purpose of invoking Rev. Stat. 3466, and thereby to secure recognition of, and protect, the Government's right of setoff. *Dewey*

Schmoll v. *United States, supra; Seaboard Surety Co.* v. *United States, supra.* On the other hand, if, as appears to be the situation in the present case, the contractor is not insolvent, and has enough assets to pay both the Government and the surety (see footnote 2, p. 4), the effect of the instant decision will be "circuity of action, inconvenience, expense, consumption of the courts' time, and injustice" (cf. *Cherry Cotton Mills, Inc.* v. *United States,* 327 U. S. 536, 539)—results which the setting off of mutual debts prevents.

CONCLUSION

For the reasons stated, it is respectfully submitted that this petition for a writ of certiorari should be granted.

George T. Washington,
Acting Solicitor General.

January 1947.

APPENDIX A

1. Rev. Stat. 236, 31 U. S. C. 71 provides:

> All claims and demands whatever by the Government of the United States *or against* it, and all accounts whatever in which the Government of the United States is concerned, either as debtor or creditor, shall be settled and adjusted in the General Accounting Office.

2. The Miller Act, 49 Stat. 793, 40 U. S. C. 270a *et seq.* provides:

> Sec. 1. That (a) before any contract exceeding $2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as "contractor":
>
> (1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.
>
> (2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person. Whenever the total amount payable by the terms of the contract shall be not more than $1,000,000 the said payment bond shall be in a sum of one-half

the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $1,000,000 and not more than $5,000,000, the said payment bond shall be in a sum of 40 per centum of the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $5,000,000 the said payment bond shall be in the sum of $2,500,000.

(b) The contracting officer in respect of any contract is authorized to waive the requirement of a performance bond and payment bond for so much of the work under such contract as is to be performed in a foreign country if he finds that it is impracticable for the contractor to furnish such bonds.

(c) Nothing in this section shall be construed to limit the authority of any contracting officer to require a performance bond or other security in addition to those, or in cases other than the cases specified in subsection (a) of this section.

Sec. 2. (a) Every person who has furnished labor or material in the prosecution of the work provided for in such contract, in respect of which a payment bond is furnished under this Act and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment bond for the amount, or the balance thereof, unpaid at the time of institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him:

Provided, however, That any person having direct contractual relationship with a subcontractor but no contractual relationship express or implied with the contractor furnishing said payment bond shall have a right of action upon the said payment bond upon giving written notice to said contractor within ninety days from the date on which such person did or performed the last of the labor or furnished or supplied the last of the material for which such claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed. Such notice shall be served by mailing the same by registered mail, postage prepaid, in an envelop addressed to the contractor at any place he maintains an office or conducts his business, or his residence, or in any manner in which the United States marshal of the district in which the public improvement is situated is authorized by law to serve summons.

(b) Every suit instituted under this section shall be brought in the name of the United States for the use of the person suing, in the United States District Court for any district in which the contract was to be performed and executed and not elsewhere, irrespective of the amount in controversy in such suit, but no such suit shall be commenced after the expiration of one year after the date of final settlement of such contract. The United States shall not be liable for the payment of any costs or expenses of any such suit.

SEC. 3. The Comptroller General is authorized and directed to furnish, to any

person making application therefor who submits an affidavit that he supplied labor or materials for such work and payment therefor has not been made or that he is being sued on any such bond, a certified copy of such bond and the contract for which it was given, which copy shall be prima facie evidence of the contents, execution, and delivery of the original, and, in case final settlement of such contract has been made, a certified statement of the date of such settlement, which shall be conclusive as to such date upon the parties. Applicants shall pay for such certified copies and certified statements such fees as the Comptroller General fixes to cover the cost of preparation thereof.

Sec. 4. The term "person" and the masculine pronoun as used throughout this Act shall include all persons whether individuals, associations, copartnerships, or corporations.

Sec. 5. This act shall take effect upon the expiration of sixty days after the date of its enactment, but shall not apply to any contract awarded pursuant to any invitation for bids issued on or before the date it takes effect, or to any persons or bonds in respect of any such contract. The Act entitled "An Act for the protection of persons furnishing materials and labor for the construction of public works", approved August 13, 1894, as amended (U. S. C., title 40, sec. 270), is repealed, except that such Act shall remain in force with respect to contracts for which invitations for bids have been issued on or before the date this Act takes effect, and to persons or bonds in respect of such contracts.

3. The Heard Act, 33 Stat. 811, 40 U. S. C. 270 which was superseded by the Miller Act, provides:

> * * * any person or persons entering into a formal contract with the United States for the construction of any public building, or the prosecution and completion of any public work, or for repairs upon any public building or public work, shall be required, before commencing such work, to execute the usual penal bond, with good and sufficient sureties, with the additional obligation that such contractor or contractors shall promptly make payments to all persons supplying him or them with labor and materials in the prosecution of the work provided for in such contract; and any person, company, or corporation who has furnished labor or materials used in the construction or repair of any public building or public work, and payment for which has not been made, shall have the right to intervene and be made a party to any action instituted by the United States on the bond of the contractor, and to have their rights and claims adjudicated in such action and judgment rendered thereon, subject, however, to the priority of the claim and judgment of the United States. If the full amount of the liability of the surety on said bond is insufficient to pay the full amount of said claims and demands, then, after paying the full amount due the United States, the remainder shall be distributed pro rata among said interveners. If no suit should be brought by the United States within six months from the completion and final settlement of said contract, then the person or persons supplying the contractor with labor and mate-

rials shall, upon application therefor, and furnishing affidavit to the Department under the direction of which said work has been prosecuted that labor or materials for the prosecution of such work has been supplied by him or them, and payment for which has not been made, be furnished with a certified copy of said contract and bond, upon which he or they shall have a right of action, and shall be, and are hereby, authorized to bring suit in the name of the United States in the district court of the United States in the district in which said contract was to be performed and executed, irrespective of the amount in controversy in such suit, and not elsewhere, for his or their use and benefit, against said contractor and his sureties, and to prosecute the same to final judgment and execution: *Provided*, That where suit is instituted by any of such creditors on the bond of the contractor it shall not be commenced until after the complete performance of said contract and final settlement thereof, and shall be commenced within one year after the performance and final settlement of said contract, and not later: *And provided further*, That where suit is so instituted by a creditor or by creditors, only one action shall be brought, and any creditor may file his claim in such action and be made party thereto within one year from the completion of the work under said contract, and not later. If the recovery on the bond should be inadequate to pay the amounts found due to all of said creditors, judgment shall be given to each creditor pro rata of the amount of the recovery. The surety on said bond may pay into court, for distribution among said claimants and creditors, the full amount of

the sureties' liability, to wit, the penalty named in the bond, less any amount which said surety may have had to pay to the United States by reason of the execution of said bond, and upon so doing the surety will be relieved from further liability: *Provided further,* That in all suits instituted under the provisions of this Act such personal notice of the pendency of such suits, informing them of their right to intervene as the court may order, shall be given to all known creditors, and in addition thereto notice of publication in some newspaper of general circulation, published in the State or town where the contract is being performed, for at least three successive weeks, the last publication to be at least three months before the time limited therefor.

APPENDIX B

Rev. Stat. 3466, 31 U. S. C. 191 provides:

Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

U. S. GOVERNMENT PRINTING OFFICE: 1947

No. 847

In the Supreme Court of the United States

October Term, 1946

The United States, petitioner
v.
The Munsey Trust Company of Washington, D. C., receiver

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

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OPINION BELOW

The opinion of the Court of Claims (R. 17–28) is reported at 67 F. Supp. 976.

JURISDICTION

The judgment of the Court of Claims was entered on October 7, 1946 (R. 28). The petition for a writ of certiorari was filed on January 3, 1947, and was granted on March 3, 1947 (R. 29). The jurisdiction of this Court rests on Section 3 (b) of the Act of February 13, 1925, as amended.

QUESTION PRESENTED

The United States owes a contractor about $12,500 under certain construction contracts; and the contractor owes the United States about $6,750 as the result of a separate, independent transaction. With respect to the construction contracts, a surety furnished bonds (as required of the contractor by law), guaranteeing payment of the contractor's obligations to materialmen and laborers; and the surety has satisfied unpaid material and labor claims, in the amount of about $13,000, under such contracts.

The question presented is whether the surety's payment of those claims deprives the Government of its otherwise unquestioned right to set off the $6,750 debt owed it by the contractor.

STATUTES INVOLVED

The pertinent portions of the statutes involved are set forth in the Appendix, pp. 41–48.

STATEMENT

The facts as found by the Court of Claims may be briefly summarized as follows:

The Federal Contracting Corporation, a New York corporation (sometimes referred to herein as "the contractor"), between May 10 and July 26, 1940, entered into six contracts with the United States, through the Public Buildings Administration, for the painting and repair of vari-

ous buildings belonging to the Government (R. 13).[1] The Aetna Casualty and Surety Company (sometimes referred to herein as "the surety") furnished the two bonds required by law of the contractor under each of the contracts, one guaranteeing the performance of the contract and the other guaranteeing payment of materialmen and laborers (R. 14).[2] In connection with each of these bonds the contractor entered into an "indemnity agreement" with the surety whereby it agreed that the surety should be subrogated to all its rights, privileges, and properties in the contracts, and assigned to the surety all monies that might be due and payable to it on its failure to pay bills incurred in the work (R. 14).

The contractor failed to make payments, totaling

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[1] These contracts were as follows (R. 13):

"Post Office, Denver, Colorado, Contract WA-2-pb-531, May 10, 1940.

"Post Office and Court House, Tulsa, Oklahoma, Contract WA-2-pb-629, July 6, 1940.

"Post Office, Whitewater, Wisconsin, Contract WA-2-pb-597, July 2, 1940.

"Customs House, Portland, Maine, Contract WA-2-pb-609, July 2, 1940.

"Post Office, Skowhegan, Maine, Contract WA-2-pb-702, July 16, 1940.

"Post Office, Gallup, New Mexico, Contract WA-2-pb-806, July 26, 1940."

[2] These bonds are required by the Miller Act, 49 Stat. 793, 40 U. S. C. 270a, *et seq.*; Appendix, pp. 41-45. The Miller Act superseded the Heard Act, 28 Stat. 278, as amended, 33 Stat. 811, 40 U. S. C. 270, Appendix, pp. 45-47.

$13,065.93, to persons who had furnished labor and material for use in the performance of five of the contracts.[3] The surety made these payments in accordance with its obligation under the payment bonds, and in connection therewith each of those persons assigned to the surety his rights against the contractor (R. 15). Upon completion of the contracts by the contractor, and after allowance of credit for payments made, there remained due and owing from the United States to the contractor a total of $12,445.03 on account of the six contracts (R. 16).

On October 18, 1940, the contractor submitted a bid in the sum of $20,743.00 to the United States for the painting of the United States Post Office at St. Louis, Missouri (R. 15). The bid was accepted, however, the contractor failed to enter into a formal contract therefor and failed to give the bond required in connection therewith (R. 15). The work was thereafter relet to a third party and performed at a cost of $7,146.50 over and above the contractor's bid (R. 15). After the application of the bid deposit of $415, there remained an indebtedness of $6,731.50 due to the United States from the contractor on account of its St. Louis bid (R. 15).

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[3] The contractor paid all the claims of the materialmen and laborers on the Denver contract. The surety was required to pay $8,640.10 on the Tulsa contract, $648.00 on the Whitewater contract, $2,528.00 on the Portland contract, $35.00 on the Skowhegan contract, and $1,214.83 on the Gallup contract (R. 15).

On June 4, 1941, one Klein, a stockholder of the contractor, instituted an action in the District Court of the United States for the District of Columbia, seeking the appointment of a special receiver[4] to receive from the United States the amounts due under the above-mentioned six contracts, and the distribution of those amounts to the laborers and materialmen or, in the alternative, to the surety, who, by counterclaim and cross-claim, joined in the same prayers (R. 15). Subsequently the Munsey Trust Company, respondent herein, a District of Columbia banking corporation, was appointed receiver and was directed by the order of its appointment to demand and receive from the United States all the proceeds of the six contracts, and to hold the proceeds of all collections for the reimbursement of the surety for expenditures made by it to those who furnished labor and material under such contracts (R. 15–16). The action was dismissed as against the Secretary of the Treasury, the Treasurer of the United States and the Commissioner of Public Buildings, who had been named as defendants (R. 16).

[4] In accordance with the established procedure in the courts of the District of Columbia, such receivership is for the purpose of taking possession of a fund or property and preventing its loss or dissipation. It does not necessarily involve insolvency, *Houston* v. *Ormes*, 252 U. S. 469, and no claim that the contractor is bankrupt, insolvent, or otherwise unable to meet his obligations, has been made by any of the parties.

Pursuant to the order of its appointment, respondent made demand upon the United States for the proceeds of the balances due under the several contracts (R. 16.) The General Accounting Office paid to respondent $5,713.53, which represented the balance due under the contracts, after deducting $6,731.50 which was applied in liquidation of the contractor's indebtedness to the United States by reason of its default under the St. Louis Post Office bid (R. 16).[5] Respondent and the surety each protested this set-off, but the Comptroller General affirmed the action taken in the matter (R. 16). Respondent reported these facts to the District Court, and was authorized to pay over to the surety $5,213.53 from the funds in its hands, retaining $500 as expenses, and to institute suit in the Court of Claims for the recovery of such further amounts as might be due under the contracts (R. 16–17).

In the Court of Claims, respondent, who had received $5,713.53, claimed that the surety had an equitable right to the fund in question (R. 13), and that respondent was entitled to a further balance of $3,568.23 for the benefit of the surety, on the ground that the surety was entitled to a total of $9,281.76, representing the total of the payments to laborers and materialmen made by

[5] Finding No. 8 of the court below (R. 16) shows how the $6,731.50, the amount applied to the St. Louis indebtedness, was allocated among the several contracts.

it under each contract, to the extent that each contract balance was sufficient to permit such payment (R. 17).[6]

The Court of Claims held that when the surety paid the claims of the laborers and materialmen, it was subrogated to all the equities in their favor, which although "not a lien in the strict and proper sense, brings kindred consequences along with it" (R. 25); that "neither the general right of the Government to make offsets nor the provisions of sec. 236 R. S. give to the claim of the Government any greater equitable force and effect than would attach to the claim of any general creditor to the contract balances in the Government's hands" (R. 27); and, therefore, that "the right of the surety and of plaintiff, as receiver, which is in the nature of an equitable lien, to have the contract balances in the Government's hands applied in satisfaction of payments made by the surety to laborers and materialmen cannot be displaced by the Government's general right of offset" (R. 28). Accordingly, it held that respondent was entitled to recover $3,568.23, and entered judgment in that amount (R. 28).

SPECIFICATION OF ERRORS TO BE URGED

The Court of Claims erred:

1. In holding that the rights of the surety upon

[6] Finding No. 10 of the court below (R. 17) shows the balances due under each contract, payments by the surety to the furnishers of labor and material under each contract, and the amounts claimed by respondent under each contract.

paying the claims of the materialmen and laborers, although "not a lien in the strict and proper sense, brings kindred consequences along with it."

2. In holding that upon paying the claims of contractor's materialmen and laborers, the rights of the surety to the fund in the hands of the Government were superior to the right of the Government to a set-off.

3. In holding that the United States, in respect of the retained fund, was merely a stakeholder.

4. In holding that, despite the general right of the Government to make offsets, its claim to the retained fund was no better than that of a general creditor of the contractor.

5. In holding that, despite the provisions of Rev. Stat. 236, the Government's claim to the retained fund was no better than that of a general creditor of the contractor.

6. In holding that the United States could not set off its claim against the contractor against the balance due to him because of the equities of the surety.

7. In entering judgment for the respondent.

SUMMARY OF ARGUMENT

I

A. The United States was both a creditor and debtor of the contractor. Even in the absence of statute, the Government had the right, which belongs to every creditor, to set off mutual

debts. Congress has, since the earliest days, required that this right of set-off be asserted affirmatively. Even in bankruptcy or receivership, where the existence of a right of set-off becomes particularly important, the right of offset has been universally recognized. Although it has the effect of paying one creditor more than another, this results in no preference since only the balance after the deduction of the set-off can properly be considered an asset of the insolvent.

In the present case, the record does not show whether the contractor is insolvent, bankrupt or otherwise unable to discharge all its obligations; respondent is a special receiver appointed in accordance with the practice of the local courts to receive and distribute a particular fund. If the contractor is solvent, denial to the United States of the right of set-off will result only in circuity of action and needless inconvenience and expense.

B. Respondent's suggestion that the debts are not mutual is based on the theory that only the contractor is indebted to the United States, and that both the contractor and surety, or the surety alone, are its creditors. But, as between the United States and the contractor, it is plain that the debts are mutual. This would seem conclusive here since respondent is a special receiver and its rights to the fund are those of the contractor, not of the surety; the latter is not entitled to any portion of the fund unless

the district court subsequently orders a distribution to it. Even if the surety had acquired some rights in the retained fund, the debts here involved would still be mutual, since the surety's obligation is merely security for that of the principal; and since, by the very nature of subrogation, the surety upon payment of the creditor is merely substituted for the creditor with respect to the latter's rights.

II

The Government's right of offset is not affected by the surety's subrogation since that doctrine does not operate to place the surety in any better position than the person whose claim has been satisfied. Accordingly, the surety here was not subrogated to any rights which could defeat the Government's offset.

A. The contractor's rights to the retained fund were not superior to those of the United States. Subrogation thereto does not place the surety in any better position.

B. Nor does subrogation to the rights of materialmen and laborers give the surety such superior rights. The finding of the court below that the materialmen and laborers and, derivatively, the surety, had rights which brought consequences "kindred to an equitable lien" was, in effect, a holding that they had the equivalent of an equitable lien on the fund. That such is the holding is clear, since the cases from which the court below quoted exten-

tively adopted the equitable lien theory, and apparently the distinction between an equitable lien and the rights here found to exist by the court below was evolved merely to avoid literal inconsistency with its other decisions.

The conflict among the various lower federal courts as to whether the materialmen and laborers and, derivatively, the surety, have an equitable lien on the retained fund, arises from the recognition that the United States has an equitable obligation to see that the laborers and suppliers are paid. Such obligations are not legally binding and, at most, are moral obligations. The purpose of the Heard and Miller Acts was merely to substitute the legal obligation of a surety for the Government's moral obligation.

Furthermore, there is nothing in the Miller or Heard Acts, or in the contract or the bond which can be construed as creating any lien, equitable or otherwise, on the retained fund in favor of the materialmen and laborers and the surety, and, as the court below has recognized, the fund is not retained to pay the materialmen and laborers. The surety admittedly took the risk that the Government might pay the retained balances to the contractor who might dissipate the money in speculation or otherwise and fail to pay the materialmen and laborers. And the surety clearly also assumed the risk that the retained fund might be used to discharge other liabilities of the contrac-

tor, such as his liability on the St. Louis bid. So far as the surety is concerned, that is the effect of what happened here, although it was accomplished by set-off rather than by delivery and redelivery of the money.

C. Since the United States had only a moral obligation to see that the laborers and materialmen were paid, payment by the surety did not subrogate it to the rights of the United States. Even if the surety had discharged a binding obligation of the Government, it nevertheless would not be subrogated to the rights of the United States, since all of the Government's claims against the contractor had not been paid. Respondent has been paid the balance remaining after full satisfaction of the Government's claims.

D. Because of this right of offset, *Prairie State Bank* v. *United States*, 164 U. S. 227, and the other cases relied on by the court below based thereon, are inapposite. In those cases there was no question involved as to the Government's right of set-off, since the United States was merely a stakeholder of a fund and asserted no claim to the fund. Moreover, in the *Prairie State Bank* case, the surety had completed performance under its performance bond. But here the surety is not subrogated to the rights of the United States, since it paid, under its payment bond, merely the claims of materialmen and laborers who had no legally binding claim against the United States, and since

all claims of the United States against the contractor had not been discharged.

Maryland Casualty Co. v. *United States*, 100 C. Cls. 513, is the only litigated case dealing with the precise question here involved. There the Court rejected the subrogation theory and allowed recovery on the assumed intention of the parties when the contract was executed. But the decision based on that assumption seems clearly wrong, since the surety should have been held to be chargeable at the time the contract was executed and the bond furnished with knowledge of the Government's right to set-off, long established by judicial decisions and administrative practice.

ARGUMENT

The claim of the surety to the retained balances under the contracts arises solely from the payments which it made pursuant to its bond securing the payment of materialmen and laborers. The contractor completed the work under the six contracts, and no question is involved as to the rights of the surety to the fund retained under the performance bonds. During the course of the performance of these contracts, the United States made progress payments to the contractor, but withheld, as provided by the contracts, certain percentage balances which became due thereunder. The contractor having become indebted to the United States by reason of its default under the St. Louis bid, the General Accounting Office when

settling the claims of the contractor, applied sufficient of the retained balances to cancel the St. Louis Post Office bid claim of the United States against the contractor.

The court below held that the relationships of debtor and creditor of the United States to the contractor should be treated separately; that, as a debtor of the contractor, the United States was merely a stakeholder of the retained fund, and that, as a creditor, the rights of the United States were not superior to those of any other general creditor. The court further held that the surety, and the respondent as special receiver, had an equitable right in the retained fund which, although not amounting to an equitable lien, brought "kindred consequences" with it, and was, therefore, superior to the rights of general creditors, including the United States.

We believe, however, that by virtue of the fact that the United States occupied the relationships of both debtor and creditor to the contractor, it had a right, under both the general law and under Rev. Stat. 236 (Appendix, *infra*, p. 41), to set off its claim against the contractor, and that this right of set-off is not subordinate to any rights or equities which the surety may have acquired by virtue of having discharged the contractor's liability to his materialmen and laborers in accordance with the terms of the payment bonds.

I

THE UNITED STATES WAS BOTH A CREDITOR AND A DEBTOR OF THE CONTRACTOR; IT HAD THE RIGHT, THEREFORE, TO SET OFF THE DEBT DUE FROM THE CONTRACTOR AGAINST THE BALANCE DUE HIM

A. Had the contractor not defaulted in making payments to its materialmen and laborers, and had the surety not become liable under its payment bonds, there could be no question about the duty and authority of the General Accounting Office to set off the contractor's indebtedness to the United States on account of its default on the St. Louis bid against the balance due from the United States under the completed contracts. For it is well settled that, even in the absence of a statute, the United States has the right to effect accounting set-offs and adjustments in connection with claims presented to it for payment; it may do so in "the exercise of the common right, which belongs to every creditor, to apply the unappropriated moneys of his debtor, in his hands, in extinguishment of the debts due to him." *Gratiot* v. *United States*, 15 Pet. 336, 370; *McKnight* v. *United States*, 98 U. S. 179, 186.

Congress has, from the earliest days of our government, charged the Treasury Department, and since 1921 the General Accounting Office, with the duty of administratively settling the Government's accounts.[7] Act of September 2,

[7] By the Act of March 3, 1875, 18 Stat. 481, as amended by the Act of March 3, 1933, Title II, sec. 13, 47 Stat. 1516, 31

1789, c. 12, sec. 3, 1 Stat. 65, 66; Act of March 3, 1817, c. 45, sec. 2, 3 Stat. 366; Rev. Stat. 236, as amended by Section 305 of the Budget and Accounting Act of June 10, 1921, 42 Stat. 20, 24.[8] And in settling the Government's accounts, the set-off of mutual claims has long been recognized as the uniform practice of the accounting officers, and it is well established that such officers have not only the power, but it is their duty, to do so, since, as stated in *Barry* v. *United States*, 229 U. S. 47, 53, "It would be folly to require the Government to pay under the one contract what it must eventually recover for a breach of the other." See also *Gratiot* v. *United States*, *supra*; *McKnight* v. *United States*, 13 C. Cls. 292, affirmed, 98 U. S. 179; *Bonnafon* v. *United States*, 14 C. Cls. 484, 489; *Taggert* v. *United States*, 17 C. Cls. 322, 327; *Howes & Co.* v. *United States*, 24 C. Cls. 170, 185–186; *Labadie* v. *United States*, 33 C. Cls. 476, 480; *Schooner Henry* v. *United*

U. S. C. 227, the Comptroller General is directed to withhold payment of a judgment creditor as an offset against the indebtedness of that creditor to the United States. This statute is similar to R. S. 236 in that it "provides a way of payment and satisfaction if the creditor shall, at the time of the presentation of his judgment, be a debtor of the United States * * *." *United States* v. *Jones*, 119 U. S. 477, 480.

[8] By the Act of June 10, 1921, 42 Stat. 20, 23 *et seq.*, the General Accounting Office, headed by the Comptroller General, was created as an independent agency, and Rev. Stat. 236 was amended to require all settlements and adjustments to be made in that office instead of in the Treasury Department.

States, 35 C. Cls. 393, 395; *American Sanitary Rug Co. v. United States*, 84 C. Cls. 417; *John P. Squire Co. v. United States*, 90 C. Cls. 276, 285, certiorari denied, 309 U. S. 689.

The setting off of mutual debts is not a right peculiar to the sovereign, but rather is one common to all creditors. Unlike the present case, where there is no allegation, claim, or finding that the contractor is bankrupt, insolvent, or otherwise unable to meet his obligations, the cases dealing with the right of offset arise most frequently when a debtor is unable to satisfy completely all his creditors and is in bankruptcy or general receivership. And even in those circumstances the right to set off debts due has been universally conceded. As this Court pointed out in *Scott v. Armstrong*, 146 U. S. 499, 511:

> * * * the bankruptcy act of 13 Eliz. c. 7, contained no provision in any way directing a set-off or the striking of a balance, and by its second section, commissioners in bankruptcy were to seize and appraise the lands, goods, money and chattels of the bankrupt, to sell the lands and chattels, "or otherwise to order the same for true satisfaction and payment of the said creditors, that is to say, to every of the said creditors a portion, rate and rate alike, according to the quantity of his or their debts." 4 Statutes of the Realm, Part I, 539. Yet, in the earliest reported decisions upon set-off, it was allowed under

this statute. *Anonymous*, 1 Mod. 215; *Curson* v. *African Co.*, 1 Vern. 121; *Chapman* v. *Derby*, 2 Vern. 117.

See also *Cumberland Glass Co.* v. *De Witt*, 237 U. S. 447; *Lowden* v. *N. W. National Bank*, 298 U. S. 160; *Fidelity & Deposit Co.* v. *Duke*, 293 Fed. 661 (C. C. A. 9); cf. *Blount* v. *Windley*, 95 U. S. 173, 177. This "precept, framed on the example of ancient laws across the seas (4 Anne, c. 17, § 11; 5 Geo. II, c. 30, § 28)," has been carried over into the United States. Cf. *Lowden* v. *N. W. National Bank*, *supra*, at 163. And in the United States, the Bankruptcy Acts have from the beginning expressly provided for such offsets.[9]

While the operation of this privilege of set-off may have the effect of paying one creditor more than another, no preference is said to be involved therein, since "it is clear that it is only the balance, if any, after the set-off is deducted which can justly be held to form part of the assets of the insolvent." *Scott* v. *Armstrong*, *supra*, at 510; *N. Y. County Bank* v. *Massey*, 192 U. S. 138, 147; *Fidelity & Deposit Co.* v. *Duke*, *supra*, at 665.

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[9] The present set-off provision (Section 68 (a)) of the Bankruptcy Act of 1898 (30 Stat. 565, 11 U. S. C. 108 (a)), was taken almost literally from Sec. 20 of the Act of March 2, 1867, 14 Stat. 517, 526. As presently worded, it provides: "(a) In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

Accordingly, even if the contractor were insolvent or bankrupt, the United States would have the right to set off mutual debts, as it did in the present case, irrespective of its priorities under Rev. Stat. 3466 or Section 64 of the Bankruptcy Act (11 U. S. C. 104).[10]

In the present case, however, the record does not show whether the contractor is able to meet his obligations. No insolvency, actual or formal, or bankruptcy has been alleged, claimed, or found. The receivership here involved is a special receivership of the type which is commonly created in the District of Columbia in accordance with the procedure and practice of its courts to receive and distribute a particular fund.[11] *Houston* v. *Ormes*, 252 U. S. 469, 473; *Morgenthau* v. *Fidelity*

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[10] For this reason, cases such as *In re Van Winkle*, 49 F. Supp. 711 (W. D. Ky.), *New York Casualty Company* v. *Zwerner*, 58 F. Supp. 473 (N. D. Ill.), and *In re Heintzelman Construction Company*, 34 F. Supp. 109 (W. D. N. Y.) are not here relevant. These cases deal with competing claims of the United States and the surety against a bankrupt, but there is no question raised or involved as to the right of set-off under Section 68 (a).

[11] Since the purpose of the receivership is to obtain payment of a fund from a Government official, where the duty to pay is purely ministerial and compellable by mandamus (*Houston* v. *Ormes*, 252 U. S. 469), it seems anomalous that the district court should appoint a receiver and at the same time dismiss the suit against the Government officials. Although the United States Attorney consented to that order of the court (R. 5-6), his consent was, of course, limited solely to the dismissal of the suit against the Government officials.

& Deposit Co., 94 F. 2d 632 (App. D. C.); *Jones* v. *Rutherford*, 26 App. D. C. 114; *Roberts* v. *Consaul*, 24 App. D. C. 551, 562; *Sanborn* v. *Maxwell*, 18 App. D. C. 245. Under that procedure, there is no requirement that the person for whose fund the receivership is created be factually or even formally insolvent or bankrupt. If the contractor here is solvent and able to discharge his liability to the United States as well as to the surety for the payments the latter made to the unpaid materialmen and laborers,[12] the claims of both the United States and the surety will be satisfied. In such circumstances, the sole function served by refusing to permit the United States to offset its mutual debts would be to remit it to its rights against the contractor, and since the money here involved is insufficient to satisfy the entire claim of the surety against the contractor, the surety would still have to pursue the contractor for the remainder. Accordingly, there would probably be three suits, where one—a suit against the contractor by the surety—would be sufficient. Such "circuity of action inconvenience, expense, consumption of the courts' time, and injustice" (cf.

[12] As has been stated, the record affords no clue as to the solvency of the contractor. It is to be doubted, as a practical matter, however, that the interested parties would have pursued the cumbersome receivership remedy if the contractor were in fact solvent and able to meet all his obligations.

Cherry Cotton Mills, Inc. v. *United States*, 327 U. S. 536, 539; *Barry* v. *United States*, 229 U. S. 47, 53) are results which the setting off of mutual debts prevents.

B. Respondent has suggested that the debts here involved are not mutual (Br. in Opp. 7–8), and that for this reason the right of set-off is not available. This contention is apparently based on the theory that only the contractor was indebted to the United States on the St. Louis bid, while both the contractor and the surety, or the surety alone, had claims to the retained fund against the United States. But if there were here involved only the respective rights of the Government and the contractor, there clearly could be no question of the mutuality of the debts, since the sole parties to the mutual debts would be the United States and the contractor, and since both debts would be liquidated. And it is difficult to see why this mutuality should disappear merely because of the claim asserted on behalf of the surety. Furthermore, to the extent that there must be an agreement between the parties that one claim shall stand against the other, such understanding has apparently always been uniformly assumed where the United States has been one of the parties to the mutual debts. See cases cited, *supra*, pp. 16–17.

This would appear to be the present situation, since the respondent is a special receiver for the fund here involved and as such must rely on the rights of the contractor thereto. The sole rights of the surety to the fund are dependent on the order of the district court appointing the special receiver. Initially that court ordered the receiver to hold the fund subject to its order (R. 5–6). "Upon consideration of the report and supplemental report of the receiver herein and the consents of counsel hereto appended," the district court ordered that the receiver pay the sums already paid over by the Government to the surety, and to institute the present proceeding (R. 11–12). It may be assumed, although it does not appear that the district court has as yet so ordered, that any monies recovered in the present proceeding will be distributed to the surety.

Even if the surety by subrogation acquired some rights in the retained fund, the debts here involved would still be mutual. *Fidelity & Deposit Co.* v. *Duke*, 293 Fed. 661 (C. C. A. 9); *Peirce* v. *Bent*, 69 Me. 381; *Downer* v. *Dana*, 17 Vt. 518; *Ex parte Hanson*, 12 Ves. 346, 18 Ves. 232. This follows from the very nature of subrogation, whereby the subrogee is merely substituted to the rights of the creditor, subject to all infirmities and defenses available against the

claim to which he is subrogated. See *infra*, pp. 24–25. And it is generally settled that upon being sued by the creditor the surety may, in the absence of hardship upon his principal, set off the claims available to his principal since in such a case the obligation of the surety which makes the debt joint is nothing more than a security for the separate debt of the principal. *Temple St. Cable Ry.* v. *Hellman*, 103 Cal. 634; *Wagner* v. *Stocking*, 22 Ohio St. 297, 301; *Gunnis, Barrett & Co.* v. *Weigley*, 114 Pa. 191; *Mahurin* v. *Pearson* 8 N. H. 539; *Newell* v. *Salmons*, 22 Barb. (N. Y.) 647; 3 Story, *Equity Jurisprudence* (14th ed.), sec. 1874; Levine, *Principal's Warranty and Offset Claims against the Creditor as Defenses to the Surety*, 30 Mich. L. Rev. 197.

II

THE GOVERNMENT'S RIGHT OF SET-OFF IS NOT AFFECTED BY THE SURETY'S RIGHT OF SUBROGATION

The court below states at one point in its opinion that the surety by paying the contractor's unpaid materialmen and laborers became subrogated to the rights of the contractor, of the materialmen and laborers, and of the United States to the retained balance in the hands of the Government (R. 18). However, the principal basis for the holding below seems to be that the surety was subrogated to the right of the materialmen and laborers to the fund, which right, the court said "even if not a lien in the strict and proper sense,

brings kindred consequences along with it" (R. 25).[13]

It is a basic principle of subrogation that "the party for whose benefit the doctrine of subrogation is exercised can acquire no greater rights than those of the party for whom he is substituted. The doctrine of subrogation was never intended to be used as an instrument to circumvent the principles of equity and by circuitous action to permit the assignee to be placed in a more advantageous position than the assignor from whom his rights devolved." *Globe Indemnity Co.* v. *United States,* 84 C. Cls. 587, 595, certiorari denied, 302 U. S. 707.[14] See also *Phoenix Insurance Co.* v.

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[13] In the Agreement of Indemnity entered into between the surety and the contractor, the contractor agreed that the surety should be subrogated to all its rights, privileges, and properties in the contracts, and assigned to the surety all moneys that might be due and payable to it upon its failure to pay bills incurred in the work, *supra,* p. 3. Neither the respondent nor the court below has suggested that this assignment vested rights to the retained fund in the surety superior to those of the United States. Nor could such a suggestion be properly advanced, since there is no question that this assignment, as such, is void as against the United States because of Rev. Stat. 3477, as amended, 31 U. S. C. Sec. 203. *Martin* v. *National Surety Co.*, 300 U. S. 588; *Prairie State Bank* v. *United States*, 164 U. S. 227; *Goodman* v. *Niblack*, 102 U. S. 556, 560.

[14] The Court of Claims in *Maryland Casualty Co.* v. *United States*, 100 C. Cls. 513, distinguished as inapplicable the *Globe Indemnity* case on the ground that in that case, the contractor's claim had been "literally nonexistent as a result of the forfeiture under the statute, so of course neither

Erie Transportation Co., 117 U. S. 312, 321; *City of Philadelphia* v. *National Surety Corporation*, 140 F. 2d 805, 808 (C. C. A. 3); *Reconstruction Finance Corp.* v. *Teter,* 117 F. 2d 716, 727 (C. C. A. 7); *Alexander* v. *Young,* 65 F. 2d 752, 757 (C. C. A. 10); *Swarts* v. *Siegel,* 117 Fed. 13, 15, 16 (C. C. A. 8); *Southern Surety Co.* v. *United States,* 75 C. Cls. 47; Sheldon, *Subrogation* (2d Ed.), §§ 1, 6. This is so because "the doctrine of subrogation is derived from the civil law, and 'it is said to be a legal fiction, by force of which an obligation extinguished by a payment made by a third person is treated as still subsisting for the benefit of this third person, so that by means of it one creditor is substituted to the rights, remedies, and securities of another * * *.'" *Aetna Life Insurance Co.* v. *Middleport,* 124 U. S. 534, 548. Thus, subrogation is merely a substitution of one person in the place of another whose claim has been satisfied, and hence the surety's rights to the retained fund in the present case depend on what rights the persons to whom he is

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the surety nor anyone else could enforce it" (100 C. Cls. at 519), whereas in the present situation, the surety had acquired rights which the principal would not have been entitled to because in his hands they would be subject to a set-off or other valid defense not involving forfeiture of the claim (100 C. Cls. at 520). Since the surety cannot obtain by subrogation any better or greater rights than the person to whose rights he is subrogated, this distinction is obviously unsound.

subrogated had against the retained fund at the time of payment.[15]

Since, as is shown below, the surety became subrogated by virtue of his payment of the unpaid claims of the contractor's materialmen and laborers to no rights which were superior to the Government's right of offset, we submit that subrogation to such rights does not enable the surety to defeat the Government's right to retain the fund through offset.

A. We have already shown *supra*, pp. 15–20, that, had the contractor not defaulted and had the surety had not been called upon to pay the unpaid materialmen and laborers, the United States would have had an undoubted right to apply the retained fund against the contractor's liability on the St. Louis bid. Hence, subrogation of the surety to the rights of the contractor does not enable him to defeat this right of the United States to offset.

B. Nor does subrogation to the rights of the materialmen and laborers give the surety any rights which are superior to the Government's right of offset. The finding of the court below that the materialmen and laborers and, deriva-

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[15] Because the rights the surety acquires by subrogation are neither greater nor better than those which the person for whom he is substituted had at the time of the payment which effected the subrogation, it has been held that "the surety is not subrogated to a right which originally existed in favor of the creditor, but which the latter released or discharged before payment by the surety." *Alexander* v. *Young*, *supra*, at 757.

tively, the surety, had rights which brought consequences "kindred to an equitable lien" is, in effect, a holding that an equitable lien did arise. This is clear from the cases from which the court below quoted extensively and upon which it relied in support of this ground of its decision, since those cases adopted the equitable lien theory. See, e. g., *Moran* v. *Guardian Casualty Co.*, 76 F. 2d 438 (App. D. C.); *Farmers' Bank* v. *Hayes*, 58 F. 2d 34, 37 (C. C. A. 6) (R. 21, 22). The distinction drawn by the court below between an equitable lien and rights which bring consequences kindred thereto is, we submit, wholly without substance. Apparently, it was evolved by that court in order to avoid literal inconsistency between its decision in this case and its decisions in other cases wherein it held that in similar circumstances no equitable lien arose. See *Seaboard Surety Co.* v. *United States*, 67 F. Supp. 969, certiorari denied March 3, 1947, No. 846, this Term, decided the same day as the present case; *Dewey Schmoll* v. *United States*, 105 C. Cls. 415, 455, certiorari denied October 14, 1946, No. 244, this Term; *Maryland Casualty Co.* v. *United States*, 100 C. Cls. 513.

As the court below recognized in *Seaboard Surety Co.* v. *United States*, *supra*, at 971, the decisions of the various lower federal courts are in conflict on the question of whether a retained fund such as is here involved is chargeable with

an equitable lien in favor of unpaid laborers and materialmen and a surety who pays their claims. *Belknap Hardware & Mfg. Co.* v. *Ohio River Contract Co.*, 271 Fed. 144 (C. C. A. 6); *United States Fidelity & Guaranty Co.* v. *Sweeney*, 80 F. 2d 235, 238 (C. C. A. 8), ~~with~~ *Third National Bank* v. *Detroit Fidelity & Surety Co.*, 65 F. 2d 548 (C. C. A. 5); *Kane* v. *First National Bank*, 56 F. 2d 534 (C. C. A. 5); *Fidelity & Deposit Co.* v. *Union State Bank*, 21 F. 2d 102 (D. Minn.). This conflict has been recognized, but not resolved, by this Court. *Martin* v. *National Surety Co.*, 300 U. S. 588, 593. See also cases cited in *Seaboard Surety Co.* v. *United States*, *supra*, at 972.

This contrariety of judicial opinion rests in part upon too literal a reading of this Court's opinion in *Henningsen* v. *United States Fidelity & Guaranty Co.*, 208 U. S. 404. See *Belknap Hardware & Mfg. Co.* v. *Ohio River Contract Co.*, 271 Fed. 144, 149 (C. C. A. 6); *United States Fidelity & Guaranty Co.* v. *Sweeney*, 80 F. 2d 235, 238 (C. C. A. 8). In the *Henningsen* case, this Court held that the surety which had paid the contractor's unpaid materialmen and laborers in accordance with the bond was entitled to the retained balances as against the bank which had loaned money to the contractor, saying "[the surety] paid the laborers and material-men and thus released the contractor from his obligations to them, and to the same extent released the Government from all

equitable obligations to see that the laborers and supply men were paid" (208 U. S. at 410).

While it is true that the United States has a moral obligation to see that the laborers and materialmen are paid, that obligation does not, as the court below has held in other cases, give rise in the materialmen and laborers to an equitable lien to the retained fund. *Seaboard Surety Co.* v. *United States, supra; Dewey Schmoll* v. *United States, supra; Maryland Casualty Co.* v. *United States*, 100 C. Cls. 513. It is settled that the materialmen and laborers do not have any lien on the work being performed (*Hill* v. *American Surety Co.*, 200 U. S. 197, 203; *Equitable Surety Co.* v. *McMillan*, 234 U. S. 448, 455), nor do they have any legally binding claim against the United States, even in the absence of a bond securing the payment of their claims. *Kellogg* v. *United States*, 7 Wall. 361; *H. Herfurth, Jr., Inc.* v. *United States*, 89 C. Cls. 122. At most, the obligation of the United States is a moral one, and even that moral obligation is not that the United States itself should pay the materialmen or laborers, but only to see that they are paid. Cf. *Henningsen* v. *United States Fidelity & Guaranty Co., supra; California Bank* v. *United States Fidelity & Guaranty Co.*, 129 F. 2d 751, 754 (C. C. A. 9).

The purpose underlying both the Heard and the Miller Acts was to discharge this moral obligation by furnishing to the materialmen and labor-

ers the obligation of a surety as a substitute for the statutory lien to which they would generally be entitled if the work were not on a public contract. *Guaranty Co.* v. *Pressed Brick Co.*, 191 U. S. 416, 425; *Hill* v. *American Surety Co.*, 200 U. S. 197, 203; *Mankin* v. *Ludowici-Celadon Co.*, 215 U. S. 533; *Equitable Surety Co.* v. *McMillan*, 234 U. S. 448, 455. And on this obligation, the surety guarantees nothing to the principal—the Government—although the latter permits an action upon the bond for the benefit of the materialmen and laborers. *Guaranty Co.* v. *Pressed Brick Co., supra; Equitable Surety Co.* v. *McMillan, supra,* at 456. Thus, as stated in H. Rep. No. 1263 and Sen. Rep. No. 1238, 74th Cong., 1st Sess., which accompanied the bill that later became the Miller Act, the sole purpose of the payment bond is "to afford greater protection to subcontractors, laborers, and materialmen," and to assure that their claims against the contractors will be paid. Section 1 (a) (2) of the Miller Act requires a payment bond with surety "for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person," and Section 2 provides that the unpaid materialmen and laborers shall have the right to sue on the payment bond for the unpaid amount or balance thereof in the name of the United States for the use of the person suing. It is clear that both the Heard

and Miller Acts were intended only to discharge the moral obligation of the United States to the materialmen and laborers by creating in them a right of action against the surety. *MacEvoy Co.* v. *United States*, 322 U. S. 102; *Texas Cement Co.* v. *McCord*, 233 U. S. 157; *Hill* v. *American Surety Co.*, 200 U. S. 197; *Guaranty Co.* v. *Pressed Brick Co., supra.* Indeed, under the Heard Act, where only a single bond was required covering both performance of the work and payment of materialmen and laborers, the unpaid claims of the materialmen and laborers were subordinate to the claims of the United States, which were to be paid in full before any distribution could be made to the materialmen and laborers. *Brogan* v. *National Surety Co.*, 246 U. S. 257, 261; *Illinois Surety Co.* v. *Peeler*, 240 U. S. 214, 218. The effect of this subordination was mitigated by the requirement in the Miller Act that two separate bonds be furnished, a performance bond to protect the Government and a payment bond to protect the materialmen and laborers.[16]

[16] The Heard Act provided for a single bond for the protection both of the Government and the suppliers of labor and materials, and to prevent the penalty of the bond from being depleted before the Government could enforce its claims the Government had sole right to sue for six months after completion of the work and final settlement. Other claimants could sue only thereafter and had to join in a single action. Serious inconveniences and delays resulted and often the claimants, in sore need of immediate funds, were compelled to settle meritorious claims for less than the full

Furthermore, there is nothing in the Miller and Heard Acts, or in the contract or the bond, which can be construed as creating any lien, equitable or otherwise, on the retained fund in favor of the laborers and materialmen, and the surety. As pointed out by the court below in *Dewey Schmoll* v. *United States, supra,* at 455:

> * * * If the contractor fails or refuses to pay its laborers and materialmen, the Government is not liable therefor, and it is not obligated or authorized to use the retained amounts to pay them. Therefore, the surety, upon payment of them, acquires no equitable lien on the retained amount, since it was not retained to secure performance of the obligation the surety discharges.

And in *Maryland Casualty Co.* v. *United States*, 100 C. Cls. 513, 520, the court below said:

> The bond involved in the instant case was not a "performance" bond, but a "payment" bond. It is not clear that moneys were withheld from the contractor in order

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amount. Hearings on H. R. 2068, et al., *Bonds of Contractors on Public Works*, House Committee on the Judiciary, 74th Cong., 1st sess.; 79 Cong. Rec. 11702, 13382; H. Rep. No. 1263 and S. Rep. No. 1238 (74th Cong., 1st sess.). The Miller Act was designed to meet these difficulties by requiring that the contractor execute two bonds, a performance bond to protect the Government and a payment bond to protect the creditors. Creditors could sue on the latter without waiting for the Government and even without waiting for completion of the project; they were given the right to sue ninety days after their labor was completely performed or materials fully supplied, and each creditor could sue separately. (See *MacEvoy Co.* v. *United States*, 322 U. S. 102, 105–106, fn. 4.)

to give the Government additional security that materialmen and laborers would be paid. So far as appears, the balance of the contract price would have been paid to Columbia, if it had not been credited on Columbia's taxes, without any investigation as to whether Columbia had paid its materialmen and laborers. If so, that would indicate that the Government, which would have no more than a moral obligation to see these creditors paid, relies entirely on the payment bond with regard to such debts of the contractor. The analogy of subrogation to additional security may, therefore, not be properly applicable to the type of bond here involved.

Since, as further pointed out in the *Maryland Casualty* case, the surety took the risk that the Government pay the contractor the retained balance which the contractor might spend "in speculation or in riotous living and fail to pay his materialmen and laborers" (100 C. Cls. at 521), the surety's risk surely also included the contractor's using the retained balance to discharge his liability to the Government on the St. Louis bid. The procedure adopted by the General Accounting Office in the present case had precisely the same result as far as the surety is concerned. The contractor was paid the amount due and owing it under the contracts by credit against his liability on the St. Louis bid, and this result was accomplished by one action instead of two.

Accordingly, since the materialmen and laborers had no equitable lien on the retained fund, the surety, upon being subrogated to their rights, likewise had no equitable lien thereon. *City of Philadelphia* v. *National Surety Corp.*, 140 F. 2d 805, 808 (C. C. A. 3); *Adamson* v. *Paonessa*, 180 Cal. 157; *Robinson Mfg. Co.* v. *Blaylock*, 192 N. C. 407.

C. Contrary to the statement of the court below (R. 18), the surety was not subrogated to any rights of the United States. The obligation discharged—the payment of claims of laborers and materialmen—was not that of the United States, for, as we have already shown, *supra*, pp. 28–31, the United States was not legally obligated to pay the laborers and materialmen, and at most had a moral obligation to see that they were paid. Secondly, even if the claims paid were binding obligations of the United States, the surety would nevertheless not be subrogated to the United States, since all its claims against the contractor had not been discharged, and it is a "familiar rule of the law of subrogation under which a surety liable only for part of the debt does not become subrogated to collateral or to remedies available to the creditor unless he pays the whole debt or it is otherwise satisfied." *United States* v. *National Surety Company*, 254 U. S. 73, 76; *American Surety Co.* v. *Sampsell*, 327 U. S. 269; *American Surety Co.* v. *Electric Co.*, 296 U. S. 133; *Jenkins* v. *National Surety Co.*, 277 U. S. 258, 266–267;

Peoples v. *Peoples Bros.*, 254 Fed. 489, 491, 492 (E. D. Pa.); *United States Fidelity & Guaranty Co.* v. *Union Bank & Trust Co.*, 228 Fed. 448, 455 (C. C. A. 6). In the present case, the United States paid to respondent the balance remaining after its claim had been fully satisfied.

D. Because of the Government's right of offset, cases such as *Henningsen* v. *United States Fidelity & Guaranty Co.*, 208 U. S. 404; *Moran* v. *Guardian Casualty Co.*, 76 F. 2d 438 (App. D. C.); *Farmers' Bank* v. *Hayes*, 58 F. 2d 34 (C. C. A. 6); *United States Fidelity & Guaranty Co.* v. *Sweeney*, 80 F. 2d 235 (C. C. A. 8); *Morgenthau* v. *Fidelity & Deposit Co.*, 94 F. 2d 632 (App. D. C.) (R. 21–24, 25), from which the court below quoted at length and upon which it relied to support its holding in the present case, are inapposite. All of these cases depend ultimately on *Prairie State Bank* v. *United States*, 164 U. S. 227, also relied upon by the court below.[17] In the latter

[17] The court below also cited *United States Fidelity & Guaranty Co.* v. *United States*, 92 C. Cls. 144 (R. 18), and *Maryland Casualty Co.* v. *United States*, 100 C. Cls. 513 (R. 19, 24). In the *Fidelity & Guaranty* case the surety elected to complete a contract after the contractor's default in accordance with the terms of its performance bond and entered into a supplemental agreement with the United States, which agreement provided that any amounts retained from payments made to the original contractor should be paid to the surety upon completion of the work. In accordance with the terms of the supplemental contract, the Court of Claims held that the surety was entitled to the retained amounts. The supplemental agreement, and the fact that

case, the question presented was whether a surety on a performance bond covering a building contract, who, upon the default of the contractor, had taken over and completed the work, acquired a better right to the sums of money retained by the Government to assure performance of the contract than a bank to which the contractor had assigned the retained sums. This Court there held that the assignment made to the bank had no effect because of Rev. Stat. 3477 forbidding the assignment of claims against the United States; and that, in any event, the surety was entitled to the fund because its rights, dating from the execution of the original contract, had been acquired prior to those of the bank.

Those cases are clearly inapplicable here. First, in the *Prairie State Bank* case, as in the other cases, the Government was merely a stakeholder, and asserted no adverse claim to the fund. In the case at bar there existed an undischarged indebtedness of the contractor to the United States, and the Government asserted a claim to the fund which was adverse to all other claims against it. Secondly, in the *Prairie State Bank* case, all of the claims of the United States against the contractor had been satisfied, and the surety who was said to be subrogated to the rights of the United States

the surety discharged his obligation under the performance bond, distinguish that case from the present case. The *Maryland Casualty* case is discussed at some length, *infra*, pp. 37–40.

had, under the performance bond, discharged the contractor's obligation to the United States. In the present case, however, all of the claims of the United States had not been discharged, and the surety paid merely the claims of the materialmen and laborers under the payment bond. Furthermore, neither that case nor any of the other cases relied upon by the court below involved any question of the right of the Government to apply a set-off.

Maryland Casualty Co. v. *United States*, 100 C. Cls. 513, is the only litigated case where the precise question here involved has been decided.[18] In that case the Court of Claims rejected as invalid the subrogation theory, which it adopted in the present case, as a ground on which to allow recovery by the surety; instead, it based its opinion on the assumed intention of the parties at the time the contract was entered into and the bonds were furnished. It held the surety did not assume under the payment bond the risk that part of the contract price would be credited against taxes or other debts, unrelated to the contract,

[18] Prior to the *Maryland Casualty* decision, the Treasury Department, until 1921, and the General Accounting Office thereafter, had consistently set off claims such as are here involved. The first case in which any question was raised as to the propriety of this practice was *Standard Surety & Casualty Co. of New York* v. *United States*, C. Cls. No. 45410, which was voluntarily dismissed by plaintiff after the Government's brief was filed.

which the contractor owed to the Government,"[19] and hence that when the surety entered into its contract of suretyship, it did so with the understanding that if it should discharge the contractor's obligation it would be entitled to the contractor's rights against the United States. But the decision in that case seems to us to be clearly wrong, since the surety should have been held to be chargeable with knowledge, actual or

[19] In its opinion, the Court of Claims pointed to what appears to be the anomalous situation, if the Government's right of set-off is sustained, of the surety being put in a position of "paying" the principal's debts to the Government if it elects to complete the contract upon the contractor's default, whereas it saves itself from such a consequence if it does not elect to complete. But in electing to complete, the surety is no more paying the contractor's debts to the United States on independent transactions than any other creditor of an insolvent or bankrupt pays those debts of his debtor which are similarly set off. However, the existence of such a set-off is only one of the factors which the surety should consider in determining whether it would be to his financial advantage to complete the project. Among the other factors to be considered is the financial condition of the contractor, since the surety in seeking reimbursement is not restricted solely to the specific funds arising from the particular contract, but may look also to the contractor's assets generally. Hence, even though the contractor is indebted to the United States, the surety may still elect to complete, because it may feel it can do the job more cheaply than others, even taking into consideration the possibility of the Government's using the contract moneys to satisfy other claims it has against the contractor. In any case, the anomaly posed by the Court of Claims would arise only where the contractor had defaulted under the performance bond and has no bearing when, as in the present case and the *Maryland Casualty* case, the surety is called upon to pay unpaid materialmen and laborers in accordance with the payment bond.

otherwise, of the Government's right of set-off, long established by judicial decisions and by statute, and by the continuous and well-recognized practice followed by the Treasury Department prior to 1921, and thereafter by the General Accounting Office. See cases cited *supra*, pp. 16-17. Indeed, the statute authorizing set-offs may well be regarded as having become, by operation of law, an inherent part of the surety's bond under the Miller Act. *Von Hoffman* v. *City of Quincy*, 4 Wall. 535, 550; cf. *Hill* v. *American Surety Co.*, held (105 C. Cls., 415, 455):

In *Dewey Schmoll* v. *United States*, *supra*, where the contractor was formally insolvent, the surety similarly urged that its undertaking on the payment bond did not include the risk that claims of the United States would be entitled to priority under Rev. Stat. 3466. The Court of Claims there held:

> When the surety on the payment bond entered into its contract of suretyship it did so with the understanding that if it discharged its principal's obligation it would be entitled to its principal's rights against the United States, but, when it did so, it had knowledge, constructive or otherwise, of this section 3466 which gave the United States priority; and the agreement of the United States that the surety should become subrogated to its principal's rights against it must be understood to have been made subject to the limitation that the Gov-

ernment should neverthele have the priority given it by this statute.

No good reason appears why the surety here should not likewise be charged with the knowledge of the Government's right of set off. See *Von Hoffman* v. *City of Quincy, supra; Hill* v. *American Surety Co., supra.*[20]

CONCLUSION

For the reasons stated, the judgment below is erroneous and should be reversed.

Respectfully submitted.

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[20] As a commercial surety, it knew the settled practice of the General Accounting Office in connection with these matters and the basis on which accounts are regularly settled. It fixed its premiums accordingly. Moreover, as a professional surety, in competition with other professional sureties, it necessarily takes risks and expects to sustain some losses. There is no room here for the application of any doctrine that doubts shall be resolved in favor of the surety. As a matter of fact, the expense of the surety bond was ultimately borne by the United States since that unquestionably was an expense taken into account by the contractor when he computed his bid.

APPENDIX

1. Rev. Stat. 236, as amended by Section 305 of the Budget and Accounting Act of June 10, 1921, 42 Stat. 20, 24, 31 U. S. C. 71 provides:

> All claims and demands whatever by the Government of the United States or against it, and all accounts whatever in which the Government of the United States is concerned, either as debtor or creditor, shall be settled and adjusted in the General Accounting Office.

2. Rev. Stat. 3477, 31 U. S. C. 203, provides in part as follows:

> All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. * * *

3. The Miller Act, 49 Stat. 793, 40 U. S. C. 270a *et seq.* provides:

> SEC. 1. (a) Before any contract exceeding $2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United

States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as "contractor":

(1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.

(2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person. Whenever the total amount payable by the terms of the contract shall be not more than $1,000,000 the said payment bond shall be in a sum of one-half the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $1,000,000 and not more than $5,000,000, the said payment bond shall be in a sum of 40 per centum of the total amount payable by the terms of the contract, Whenever the total amount payable by the terms of the contract shall be more than $5,000,000 the said payment bond shall be in the sum of $2,500,000.

(b) The contracting officer in respect of any contract is authorized to waive the requirement of a performance bond and payment bond for so much of the work under such contract as is to be performed in a foreign country if he finds that it is impracticable for the contractor to furnish such bonds.

(c) Nothing in this section shall be construed to limit the authority of any contracting officer to require a performance bond or other security in addition to those, or in cases other than the cases specified in subsection (a) of this section.

SEC. 2. (a) Every person who has furnished labor or material in the prosecution of the work provided for in such contract, in respect of which a payment bond is furnished under this Act and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on such payment bond for the amount, or the balance thereof, unpaid at the time of institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him: *Provided, however,* That any person having direct contractual relationship with a subcontractor but no contractual relationship express or implied with the contractor furnishing said payment bond shall have a right of action upon the said payment bond upon giving written notice to said contractor within ninety days from the date on which such person did or performed the last of the labor or furnished or supplied the last of the material for which such claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed. Such notice shall be served by mailing the same by

registered mail, postage prepaid, in an envelope addressed to the contractor at any place he maintains an office or conducts his business, or his residence, or in any manner in which the United States marshal of the district in which the public improvement is situated is authorized by law to serve summons.

(b) Every suit instituted under this section shall be brought in the name of the United States for the use of the person suing, in the United States District Court for any district in which the contract was to be performed and executed and not elsewhere, irrespective of the amount in controversy in such suit, but no such suit shall be commenced after the expiration of one year after the date of final settlement of such contract. The United States shall not be liable for the payment of any costs or expenses of any such suit.

SEC. 3. The Comptroller General is authorized and directed to furnish, to any person making application therefor who submits an affidavit that he supplied labor or materials for such work and payment therefor has not been made or that he is being sued on any such bond, a certified copy of such bond and the contract for which it was given, which copy shall be prima facie evidence of the contents, execution, and delivery of the original, and, in case final settlement of such contract has been made, a certified statement of the date of such settlement, which shall be conclusive as to such date upon the parties. Applicants shall pay for such certified copies and certified statements such fees as the Comptroller General fixes to cover the cost of preparation thereof.

SEC. 4. The term "person" and the masculine pronoun as used throughout this Act shall include all persons whether individuals, associations, copartnerships, or corporations.

SEC. 5. This act shall take effect upon the expiration of sixty days after the date of its enactment, but shall not apply to any contract awarded pursuant to any invitation for bids issued on or before the date it takes effect, or to any persons or bonds in respect of any such contract. The Act entitled "An Act for the protection of persons furnishing materials and labor for the construction of public works", approved August 13, 1894, as amended (U. S. C., title 40, sec. 270), is repealed, except that such Act shall remain in force with respect to contracts for which invitations for bids have been issued on or before the date this Act takes effect, and to persons or bonds in respect of such contracts.

4. The Heard Act, 28 Stat. 278, as amended by 33 Stat. 811, 40 U. S. C. 270, which was superseded by the Miller Act, provided:

> * * * any person or persons entering into a formal contract with the United States for the construction of any public building, or the prosecution and completion of any public work, or for repairs upon any public building or public work, shall be required, before commencing such work, to execute the usual penal bond, with good and sufficient sureties, with the additional obligation that such contractor or contractors shall promptly make payments to all persons supplying him or them with labor and materials in the prosecution of the work provided for in such contract; and any person, company, or corporation

who has furnished labor or materials used in the construction or repair of any public building or public work, and payment for which has not been made, shall have the right to intervene and be made a party to any action instituted by the United States on the bond of the contractor, and to have their rights and claims adjudicated in such action and judgment rendered thereon, subject, however, to the priority of the claim and judgment of the United States. If the full amount of the liability of the surety on said bond is insufficient to pay the full amount of said claims and demands, then, after paying the full amount due the United States, the remainder shall be distributed pro rata among said interveners. If no suit should be brought by the United States within six months from the completion and final settlement of said contract, then the person or persons supplying the contractor with labor and materials shall, upon application therefor, and furnishing affidavit to the Department under the direction of which said work has been prosecuted that labor or materials for the prosecution of such work has been supplied by him or them, and payment for which has not been made, be furnished with a certified copy of said contract and bond, upon which he or they shall have a right of action, and shall be, and are hereby, authorized to bring suit in the name of the United States in the district court of the United States in the district in which said contract was to be performed and executed, irrespective of the amount in controversy in such suit, and not elsewhere, for his or their use and benefit, against said contractor and his sureties, and to prosecute the same to final judgment and

execution: *Provided,* That where suit is instituted by any of such creditors on the bond of the contractor it shall not be commenced until after the complete performance of said contract and final settlement thereof, and shall be commenced within one year after the performance and final settlement of said contract, and not later: *And provided further,* That where suit is so instituted by a creditor or by creditors, only one action shall be brought, and any creditor may file his claim in such action and be made party thereto within one year from the completion of the work under said contract, and not later. If the recovery on the bond should be inadequate to pay the amounts found due to all of said creditors, judgment shall be given to each creditor pro rata of the amount of the recovery. The surety on said bond may pay into court, for distribution among said claimants and creditors, the full amount of the sureties' liability, to wit, the penalty named in the bond, less any amount which said surety may have had to pay to the United States by reason of the execution of said bond, and upon so doing the surety will be relieved from further liability: *Provided further,* That in all suits instituted under the provisions of this Act such personal notice of the pendency of such suits, informing them of their right to intervene as the court may order, shall be given to all known creditors; and in addition thereto notice of publication in some newspaper of general circulation, published in the State or town where the contract is being performed, for at least three successive weeks, the last publication to be at least three months before the time limited therefor.

5. Rev. Stat. 3466, 31 U. S. C. 191, provides:

> Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

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IN THE

Supreme Court of the United States

October Term, 1946.

No. 847.

The United States, *Petitioner*,

v.

The Munsey Trust Company of Washington, D. C., *Receiver*.

On Petition for a Writ of Certiorari to the Court of Claims.

BRIEF FOR RESPONDENT.

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Opinion Below.

The opinion of the Court of Claims (R. 17-28) is reported in 67 F. Supp. 976.

Jurisdiction.

Petitioner has invoked the jurisdiction of this Court under Section 3 (b) of the Act of February 13, 1925, as amended. The judgment of the Court of Claims was entered on October 7, 1946. (R. 28)

Question Presented.

After a contractor has breached its contract and bond by failing to pay labor and material claims and the surety upon its bond has remedied the breach by paying such claims, may the United States appropriate the contract balances for the payment of their own independent claims, unrelated to the contract and bond, arising out of transactions entered into subsequently and thereby preclude the application of those contract balances to the losses which the surety suffered?

Statement.

In addition to the statement made by petitioner, it should be pointed out that the transaction out of which the independent claim of the United States arose, was entered into subsequent to the giving of the bonds under which the surety responded. It should also be noted that a $415 bid deposit was taken by the United States as security for the proposed $20,743 contract in connection with which their independent claim has arisen. (R. 15) It is obvious that a deposit of this amount is grossly disproportionate to the amount of the proposed contract and inadequate to protect the United States from the hazard incurred.

BRIEF.

The Decision Below is Correct.

This Court held in a case involving a similar contract and bond, *Martin v. National Surety Company*, 300 U. S. 588, that:

> "The terms of the bond are read into the contract, and there is default under the contract when there is default under the bond."

As a consequence of the contractor's failure to pay labor and material bills it necessarily forfeited its rights to receive payment under the contracts involved here. Where

the contractor breaches its contract by failing to complete the work, or to pay the labor and material claims, the accumulated balance of the contract in the hands of the Government constitutes a fund which is available for remedying the damage which results. In other cases the Government appears to have contended without success that it could require the completion of the work by the surety, and then appropriate the contract balance in the extinguishment of unrelated claims against the contractor. *United States Fidelity & Guaranty Co.* v. *U. S.*, 92 C. Cls. 144. No more reason exists why the surety should be required to pay claims for the labor and material which created the finished work while the United States are thereafter permitted to appropriate the contract balances for the payment of claims which arose out of transactions entered into subsequently and with which the surety had no connection or obligation.

The United States have required by the terms of the Miller Act, Act of August 25, 1935, 49 Stat. 794, 40 U. S. C. A., 270 a-d, that the contractor give bond with surety as a condition precedent to the making of the contract.

> "Before any contract exceeding $2,000 in amount for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, * * *
>
> (1) A performance bond with a surety or sureties * * *.
>
> (2) A payment bond with a surety or sureties * * * for the protection of all persons supplying labor and material in the prosecution of the work * * *."
> Title 40 U. S. C. A., 270(a)

The contract and the bond create a contractual relation between the Government, the contractor and the surety. It is inescapable that there results an obligation on the part of the Government not to defeat the expectation of the parties and the obvious intendment of the contract, by diverting the contract proceeds so that they cannot be used for the

construction of the work and the payment of labor and material bills. If the United States were permitted to divert the final contract balances, they will be equally free to divert every installment of the contract payments commencing with the first, thus creating a liability far beyond anything which could have been intended when the bonds were given.

Petitioner argues (Petition pp. 8-9) that the labor and material furnishers have no legally binding claim against the United States and that as a consequence the surety could have none. But there is no claim here that the United States must reimburse the surety for the claims which it pays. It is only the contract proceeds which are the subject of the controversy. The judgment of the Court below did not fully reimburse the surety (R. 16-17), nor did the surety make claim to the proceeds of any contract in excess of the loss which it had incurred under that contract. (R. 17)

If persons furnishing labor and material for the construction of public works do not have a legally binding claim against the United States, they have a claim which this Court has recognized as a moral claim. *Henningsen v. United States Fidelity & Guaranty Company*, 208 U. S. 404. Such claims have been recognized even before the passage of the original Heard Act, Act of August 13, 1894, 28 Stat. 278, 40 U. S. C. A. 270 (Petition pp. 18-20), *Greenville Savings Bank v. Lawrence*, 76 Fed. 545. The courts have repeatedly held that the surety, upon responding to claims made on its bonds, either for performance or the payment of labor and material, becomes subrogated to the rights of the United States. It was said in a case where a surety sought to recover the proceeds of such a contract from a third party, that:

> "Thus, in consequence of Anderson's (contractor's) default, the $37,170.04 then in the hands of the United States became a fund which the United States was entitled to apply to the payment of the materialmen's claims, and which appellee, as subrogee of the United States, was entitled to have applied in reimbursement

of the $21,609.28 expended by it in paying such claims; and appellee's right to have the fund so applied was superior to any right of Anderson or Anderson's assignees—if any." (parenthetical expression added) *California Bank* v. *U. S. F. & G. Co.*, 129 F. (2d) 751 (C. C. A. 9th).

(See also *Hardaway* v. *National Surety Company*, 211 U. S. 552; *In re Scofield Co.*, 215 Fed. 45 (C. C. A. 2d); *American Bonding Company* v. *Central Trust Co.*, 240 Fed. 400 (C. C. A. 7th.)

In *Belknap Hardware Mfg. Co.* v. *Ohio River, etc., Company*, 271 Fed. 144 (C. C. A. 6th) it was said with reference to *Henningsen* v. *United States Fidelity & Guaranty Company*, 208 U. S. 407:

> "Since there cannot be the transfer of a right by subrogation, unless there is a right to be transferred, we think the necessary effect of the decision is to hold that the laborers and materialmen, in spite of or in addition to the giving of the bond, had an original and continuing equitable priority in the fund, and that it was this right to which the surety was subrogated. This is not stated in the opinion in very express terms, but it had been pressed upon the Court (208 U. S. 407, 408; 28 Sup. Ct. 389, 52 L. Ed. 547) that there could be no such subrogation without such a right, and that there was no such right. On page 410, of 208 U. S., on page 391 of 28 Supreme Court (52 L. Ed. 547), the Court refers to and assumes that the Government, after the bond was given was still charged with 'equitable obligations to see that the laborers and supplymen were paid.' We are constrained to think that the decision necessarily rests upon the existence of this right as one entitling these claimants to priority in payment out of the fund, and therefore as entitling the surety, as their equitable assignee by subrogation, to the same priority."

Petitioner's argument seems to admit that the surety's right to the contract proceeds is superior to that of any claimant other than the United States. Indeed the General

Accounting Office paid over to the respondent all of the contract balances which it did not appropriate to extinguish **the contractor's independent indebtedness (R. 16).** That Office has recognized the surety's rights in the past. 8 Comp. Gen. 435, 8 Comp. Gen. 58.

The Government argues that all of the claims of the United States had not been satisfied citing *United States* v. *National Surety Co.*, 254 U. S. 73 (Petition p. 11). The doctrine of that case has no application here. That was a case where the bond secured only a part of the very loss on account of which the Government claimed. The surety paid the penalty of its bond, but that did not satisfy the debt. The surety was denied the right of parity with the Government since the very debt secured remained partially unpaid. **In the case at bar the obligations secured have** been paid in full and nothing further remains due. The claim of the United States springs from a totally foreign transaction. The effort of the Government to extend the rule of *United States* v. *National Surety Co.* to the case at bar would result in requiring the surety to pay other debts of the contractor which it had never undertaken to secure. *Maryland Casualty Co.* v. *U. S.*, 100 C. Cls. 513.

The Government's claimed right of set-off in circumstances such as those here involved has not been established by any settled line of administrative practice. In fact, the action of the General Accounting Office proceeds upon an administrative rule that all doubtful cases should be decided in favor of the Government, leaving the claimant to pursue his remedy in the courts. That office recognizes the controversial character of such questions as these and that the courts are the proper forum for their determination. Decisions of the General Accounting Office guided by such a standard cannot form precedents and lend no aid to courts in their decision of controversies.[1] In addition to

[1] The reasons for this are that the General Accounting Office functions as a court of last resort so far as the Government is concerned, its decisions in that respect being by law conclusive upon

this, the function of the General Accounting Office is no more than that of an accountant or auditor. The decisions made there are administrative only, *Illinois Surety Company* v. *United States to the use of Peeler*, 240 U. S. 214, and are always subject to judicial review. Not only did the decision of the General Accounting Office in this case (R. 20-21) run counter to the decisions of the Federal courts generally, but it is admittedly in head on conflict with the determinations made in the very court set up to hear controversies between the Government and its citizens. (R. 20)

The right which the United States enjoy to liquidate their own claims out of funds of a debtor held in their hands is not, strictly speaking, a right of set-off. That term is generally understood to include only such rights as have been accorded by statute. No such statutory right has ever been granted to the United States. The United States have followed a practice arriving at a result substantially the same as that obtained under ordinary statutes of set-off. The right of withholding by the United States, however, has been said to be:

> "* * * but the exercise of the common right which belongs to every creditor, to apply the unappropriated monies of his debtor, in his hands, in extinguishment of the debts due to him." *Gratiot* v. *United States*, 15 Pet. 336.

The only provision in the Federal statutes expressly relating to set-off by the United States is found in Title 31 U. S. C. A. Section 227, Act of March 3, 1875, 18 Stat. 481, authorizing the Comptroller General to withhold the payment of

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the executive branch of the Government. *Skinner & Eddy Corporation* v. *McCarl*, 275 U. S. 1, 4-5 footnote. There is no provision for appeal to the courts from such decisions where they run against the Government. But where the claim is disallowed the claimant is free to appeal to the court for a review of the decision. *Savings Bank of Pittsburgh* v. *United States*, 16 C. Cls. 335, 351. Probably a large portion of the decisions of the Court of Claims involve review of settlements of the General Accounting Office.

final judgments in any instance where the United States have a claim against a judgment creditor, and providing further that the United States shall be required promptly to institute suit upon their own claim. That statute has no application here.

It is characteristic of set-off that the claims which are to be balanced against one another must be mutual. This is demonstrated by *Gray v. Rollo,* 18 Wall. 629. There a bankrupt insurance company was the holder of notes signed by one Gray. Gray was also a member of a partnership to which the insurance company was indebted upon insurance policies. When an effort was made on behalf of the insurance company to collect upon Gray's notes, he defended and endeavored to set off the claims of his partnership upon the insurance policies. His defense of set-off was denied because of the lack of mutuality of the balancing credits. It was said:

> "The insurance company, so far as appears, took the notes without any reference to the policies of insurance; and Gray Brothers insured with the company without any reference to the notes. Neither transaction was entered into in consequence of or in reliance on the other; and no agreement was ever made between the parties that one claim should stand against the other."

The reasoning of this case is particularly applicable to the facts in the case at bar, since in the case at bar the surety stands as a third party, having a well recognized interest in the proceeds of the contract.[2]

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[2] *Cherry Cotton Mills Inc.* v. *United States*, 327 U. S. 536, cited by petitioner is not in point here. That case involved the situation of a debtor atempting to escape the payment of an admitted obligation to the R. F. C. through the purely procedural objection that such a debt was not a proper set-off in the Court of Claims. The question here presented is a question of substantive law, namely, whether the United States can in effect require a surety to pay debts of its principal by appropriating contract funds which the surety has created as a consequence of its having paid for labor and material used in the performance of public work.

The Conflict Between the Decisions of the Court of Claims and the Policy of the General Accounting Office.

Petitioner's brief refers to a practice of the General Accounting Office in setting off "mutual claims"[3] in situations such as that presented here. It is the information of counsel that such situations have arisen but rarely in past years, although it now appears that they are arising more frequently and may continue to arise with even greater frequency.[4] It is also proper to point out that the General Accounting Office has expressed an intention of declining to follow the decisions of the Court of Claims dealing with this subject until this Court shall have passed on the question. (R. 20-21, 8-11) It is the information of counsel that the General Accounting Office intends to adhere to this course.

Since the General Accounting Office denies a surety paying labor and material claims reimbursement from the contract funds if the United States have unrelated claims of any kind against the contractor, the surety is obliged in such instances, to prosecute a suit through the Court of Claims, with the expense and consumption of time necessarily involved.
Inasmuch as that court, as in this case, has upheld the right of the surety to such reimbursement, *Maryland Casualty Co.* v. *U. S.*, 100 C. Cls. 513, the result is continuous litigation over the identical legal question, a situation which appears to be no more satisfactory to the Government than to the sureties who are obliged to sue.

Respectfully submitted,

Alexander M. Heron
William L. Owen
Attorneys for Respondent.

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[3] It has been pointed out (supra p. 8) that the claims are not mutual.

[4] The case of *Seaboard Surety Co.* v. *United States*, 67 F. Supp. 969 (C. Cls.) cited by the petitioner is the subject of a pending application for certiorari, No. 846, October Term, 1946.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

No. 847.

THE UNITED STATES, *Petitioner*,

v.

THE MUNSEY TRUST COMPANY OF WASHINGTON, D. C., *Receiver*.

On Writ of Certiorari to the Court of Claims.

BRIEF FOR RESPONDENT.

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Attorneys for Respondent.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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OPINION BELOW.

The opinion of the Court of Claims (R. 17-28) is reported in 67 F. Supp. 976.

JURISDICTION.

Petitioner has invoked the jurisdiction of this Court under section 3 (b) of the Act of February 13, 1925, as amended. The judgment of the Court of Claims was entered on October 7, 1946. (R. 28). The writ was granted on March 3, 1947 (R. 29).

QUESTION PRESENTED.

A statute [1] requires that before an administrative agency of the United States shall award any contract for the construction, alteration or repair of any public building or public work, it shall take, and the contractor shall give, bonds with surety, conditioned for the performance of the work and for the protection of all persons supplying labor and material in the work. Is it not implicit in the whole transaction that the contract price shall not be invaded by the United States for the satisfaction of its wholly *unrelated* and independent claims against the contractor to the damage of the surety which has performed the contractor's obligation, both to the United States and to the furnishers of labor and material by paying the latter?

STATEMENT.

It should be observed that the bid for work at the St. Louis Post Office was not made until subsequent to the making of the contracts which the surety bonded, (R. 15, 13) and as a consequence the independent claim based on that transaction did not arise until after the giving of the bonds here involved. The deposit taken by the Government in the amount of $415.00 to secure the bid of $20,743.00 for painting the St. Louis Post Office, is in the amount of approximately 2% and appears to be grossly inadequate.

In making its settlement, the General Accounting Office proceeded in total disregard of the surety's rights. In the cases of three of the contracts [2] (R. 16) the General Accounting Office paid over to the receiver the full contract balances although payments by the surety in each instance were less than those balances (R. 17).

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[1] Miller Act, 40 U. S. C. 270a, et seq., App. pp. 25-26.

[2] Whitewater, Wisconsin
Portland, Maine
Skowhegan, Maine

ARGUMENT.

Summary of Argument.

1. The contract for the work and the bonds required by the Government in connection therewith impose upon the contractor the obligation of paying all furnishers of labor and material. When the contractor fails to make such payment, he breaches his contract and bond just as much as though he had failed to execute the work. When the contractor breaches his contract, he is not entitled to receive further payments under it. When the surety pays labor and material furnishers, it is performing the contract and answering under the bond by discharging the obligation which it assumed both to the Government and to supplymen. The contract balances are earned by it and belong to it.

2. The Government's rights of off-set are equitable in nature. They have never been prescribed by statute. There is an absence of mutuality between the debts in this case. The debt due to the Government concerns the contractor alone. The debt owed by the Government is primarily an obligation running to the surety as a consequence of its performance of the contract requirements.

3. In innumerable cases which have arisen in the Federal Courts over the last fifty years involving the disposition of such contract proceeds, the courts have awarded them to the surety which either completed the work or paid furnishers of labor and material. This has been done on the basis of such equitable rules as were conveniently applicable to the particular case. It has been held that the surety was subrogated to the rights of the Government. In other cases the surety has been held to be entitled to subrogation to the rights of the furnishers of labor and material. In a few cases subrogation to the contractor's rights in the fund was the ground of decision; but these cases are rare because the contractor's rights to the fund

ordinarily become so far subordinate by the time of the contest, that they are worthless. The fund has also been held subject to an equitable lien in favor of furnishers of labor and material and such suppliers have been allowed to maintain an action in their own name to satisfy their claims against it.

4. Various contentions of the Government's brief—that allowance of an off-set will result in greater convenience as a matter of procedure, that the receiver succeeded to no more than the contractor's claim against the United States, that subrogation must be denied because the debt is not yet paid, that the making of off-sets is a well established administrative practice, are all shown to be inapplicable to the situation in the case at bar.

1. The Surety Has a Legal Right to the Contract Balances.

The Court of Claims decided this case upon the basis of equitable rules which have developed in a vast body of cases since the decision of *Prairie State National Bank* v. *United States*, 164 U. S. 227. The case will bear a more direct analysis. The whole implication of the transaction is that *the contract proceeds were to form the means of carrying out the project* and that they were to be available to the contractor, to the surety, and to the Government for that purpose. In entering into the transaction, the Government assumed to the surety an obligation not to defeat this purpose by diversion of the contract funds for its own private convenience. It has no right to appropriate the contract funds for the satisfaction of unrelated indebtedness of the contractor to it. Respondent is content to present the case upon this ground alone. Discussion of equitable rules applied in this field is included to show the extent to which development in those lines is in complete accord with the notion that the Government has such a direct legal responsibility.

When the contractor failed to pay its bills for labor and material furnished in the performance of the contract, it

breached not only the bond, but the contract as well. In *Martin v. National Surety Company*, 300 U. S. 588, the surety on a bond given under the prior[3] statute sued to impound the contract proceeds for its indemnity and exoneration from labor and material claims made against it. The last progress payment had been collected by Martin, the assignee of the contractor, while the retained percentages were in the hands of the Government. In awarding the contract balances to the labor and material furnishers, in whose favor the surety withdrew on becoming insolvent, this Court said, at pp. 593-4:

> "The proceeds of the contract, when collected by Martin under his power of attorney, were received by him with knowledge of the agreement between the contractor and the surety whereby such proceeds became a fund to be devoted in the first instance to the payment of materialmen and others similarly situated. In our view of the law, the equities in favor of materialmen growing out of that agreement were impressed upon the fund in the possession of the Court."

At p. 595:

> "The contractor undertook that materialmen would receive their money promptly while the work was going on. In failing to pay them, he violated a duty to them, but a duty also to the Government, for the default was a breach of the condition of the bond. If the assignment to the surety creates a lien upon the fund, the contractor will be compelled to fulfill the duty thus assumed."

And again, at pp. 597-8:

> "But the statute directs that a bond for the prompt payment of materialmen and laborers shall be executed by the contractor before the commencement of the work. Not only that, but the contract with the Government, which was drawn in the standard form, is a confirmation and adoption of the statutory duty. The

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[3] 40 U. S. C. 270 etc., App. p. 26.

terms of the bond are read into the contract, and there is default under the contract when there is default under the bond."

As a consequence of the default of the contractor in the payment to furnishers of labor and material, it forfeited its right to receive payment under the contracts. It was not until the surety remedied this breach by coming forward and paying these claims, that the contract balances became payable. It would be a strange result, if the surety's payment of labor and material bills had the effect of enabling the Government to apply to its own independent claims against the contractor, the funds thus freed from the penalty of the breach. The contract and bond contemplated not only that the work would be done, but also that labor and material bills would be paid as well. The failure to do either was a breach of the contract and of the bond which was required both by the statute and the contract. The surety mends the breach as much by paying labor and material claims as it does by performing the work. There can be no question but that if the surety had completed the work it would be entitled to so much of the remaining contract balance as would be necessary to exonerate or indemnify it from loss. *United States Fidelity & Guaranty Co.* v. *United States*, 92 C. Cls. 144. The reason for this is that if the surety does not elect to complete the work,[4] and the Government itself completes, the measure of damages chargeable to the contractor and the surety is only the excess cost of completion after first making allowance for the credit represented by the unpaid balance of the contract price. *Lacy* v. *Maryland Casualty Co.*, 32 F. (2d) 48 (C. C. A. 4th); 16 Comp. Dec. 351; 26

[4] The bonds taken by the United States are for the payment of a sum of money. The obligation of the bond is discharged by the performance of its condition (R. 14). The surety does not agree to perform the work, but to be answerable in damages for non-performance. Not infrequently the surety actually undertakes the completion of a defaulted contract in order to minimize the damage which ordinarily follows.

Comp. Dec. 467; 8 Comp. Gen. 58; 8 Comp Gen. 435. No different result should follow where the breach consists of a failure to pay furnishers of labor and materials, and the surety comes forward and pays them.

It is obvious that the Government, the contractor, and the surety all contemplated that the contract funds were to be available to the contractor for the purpose of executing the work. Execution of the work necessarily includes payment for labor and material. This is demonstrated by the provisions of the standard form of Government contract which authorize payment to the contractor in installments as the work progresses with an amount, usually 10 per centum, to be withheld until completion and acceptance of the work. Material departures from the contract terms by the party secured would release the security of the bond by affording the surety the defense that its obligation was altered without its consent. Here the surety is entitled to insist upon performance by the Government through payment by the Government of so much of the contract balances as will prevent an enlargement of its obligations under the bonds.

The reasonableness of the conclusion reached by the Court of Claims in this case is obvious when it is considered that the most important factor for the surety's determination when entering upon its obligation is whether or not the contract price is fairly adequate to enable the contractor to complete his performance. If it appears that the contract price is wholly inadequate, the surety would foresee failure and decline to give bond. The surety's risk is calculated on the basis of this being the main risk involved, and not upon an effort to forecast the outcome of all past and future dealings which the contractor may have with the Government. The contention of the Government in this case would have the effect of making the contract price a matter of variable uncertainty and would place upon the surety a hazard far beyond anything which could have been contemplated when the contract was written. It must be borne in mind that all contractors with the Government will

be indebted to it continuously for taxes of all kinds, and some for payments of large amounts under the Renegotiation Act [5] and perhaps for penalties and fines of various kinds which may easily amount to considerable sums. It is the Government's contention that all such items as these may be charged against contract balances earned by a contractor under some unrelated contract and that the surety for that contract may in turn be held for the completion and payment of labor and material bills which the contractor failed to pay. It was obviously considerations such as these which moved the Court of Claims in *Maryland Casualty Company* v. *United States*, 100 C. Cls. 513, to say, at pp. 521-2:

> "The effect of the contract and the bonds is that the contractor promises the Government that it will build the structure, *and* will pay the laborers and materialmen. The Government takes two separate bonds to secure the fulfillment of these promises, since its interest in the first is more physical and direct than in the second. But when the surety pays the laborers and materialmen, it is performing the contract as much as when it completes the building. We see no more reason why the parties should intend that, either under the guise of building a building, or of paying laborers and materialmen, both of which the surety has promised will be done, it should in reality, and because of the ease of bookkeeping, be paying the contractors' taxes or other debts, which it has not promised will be done."

See also *Continental Casualty Co.* v. *City of Pittsburgh*, 68 F. Supp. 805 (D. C. W. D., Pa.).

In the present case, if the Government's contention is sound, the surety would be in a better position if it had written a bond for the unrelated St. Louis Post Office work. It would then have received compensation by way of a premium for the assumption of that risk. The Government's present contention is that this surety must pay that loss

[5] Act of April 28, 1942, 50 U. S. C. App. 1191, as amended.

even though it had no connection with the bid and received no compensation for the assumption of the risk. In other words, the Government proposes to charge the surety with responsibility for every debt of the contractor, whether antecedent or subsequent to the bond.

This Court, in construing the provisions of the Government contract involved in *Prairie State National Bank* v. *United States*, 164 U. S. 227, said, at p. 233:

> "That a stipulation in a building contract for the retention, until the completion of the work, of a certain portion of a consideration, is as much for the indemnity of him who may be guarantor of the performance of the work as for him for whom the work is to be performed; that it raises an equity in the surety in the fund to be created; and that a disregard of such stipulation by the voluntary act of the creditor operates to release the sureties, is amply sustained by authority."

And this rule has been applied in cases involving state agencies where similar bonds have been given to secure completion of the work and payment to labor and material furnishers. In such cases where the state agency has paid out retained percentages with the contractor's authorization after notice of outstanding claims against the surety, the agencies have been held liable to the surety for the amounts thus wrongfully disbursed. In *Claiborne Parish School Board* v. *Fidelity & Deposit Co. of Maryland*, 40 F. (2d) 577 (C. C. A. 5th) it was said, at p. 579:

> "On the contrary, a payment of the balance to the contractor or to the bank, with actual knowledge that there were claims outstanding and unpaid, which the appellee (surety) would be compelled to pay, and that it would have to resort to the fund to be reimbursed therefor, would be a wrongful payment as to appellee. The fund was in the possession of appellant for the joint protection of itself and appellee, and it could not lawfully part with the fund to the bank which had no prior right in it, to the detriment of the appellee which it knew would have occasion to resort to it, to secure reimbursement for amounts appellee would be com-

pelled to pay out under the terms of its bonds by the terms of which the fund also provided for its security in that respect." (parenthetical word supplied)

Similar conclusions were reached in *National Surety Co.* v. *County Board of Education*, 15 F. (2d) 993 (C. C. A. 4th); *United States Fidelity & Guaranty Co.* v. *City of Bristow*, (D. C., E. D. Okla.) 4 F. (2d) 810, *Ft. Worth Independant School Dist.* v. *Aetna Casualty & Surety Co.*, 48 F. (2d) 1, (C. C. A. 5th) cert. den. 284 U. S. 645; *Continental Casualty Co.* v. *City of Pittsburgh*, 68 F. Supp. 805 (D. C., W. D. Pa.) It does not appear that any different result should follow because the Federal Government is involved rather than a State Government or agency.

There can be little question under the authorities but that a private agreement between the contractor and the Government to reduce the contract price without the knowledge of the surety would relieve the surety, if not entirely, at least *pro tanto* from the obligation of its bond. What the Government now proposes is this very step. An offset is accomplished on the fundamental notion that debts are mutual and that the parties are agreed that they may be set-off against one another. The consequence of this is that the Government now tells the surety that it has agreed with the contractor to divert the proceeds of the secured contracts to other ends than payment for labor and material which entered into the performance of the work.

Performance by the surety of the contractor's obligation to pay suppliers of labor and material, the contract provision which retains a portion of the contract price as much for the benefit of the surety as for the Government, spell out an obligation by the Government to pay the balances earned by the surety to it and forbid their application to other debts of the contractor for the convenience of the Government.

2. The Government is Not Entitled to Assert a Set-Off.

The extent of the right of set-off in favor of the United States is shrouded in obscurity. There is no statute which specifically defines the class of cases in which it is to be allowed, or the limits within which it is to be confined. It has been said to be:

> "* * * but the exercise of the common right, which belongs to every creditor, to apply the unappropriated monies of his debtor, in his hands, in extinguishment of the debts due to him." *Gratiot* v. *United States*, 15 Pet. 336 at p. 370.

It has been allowed in cases where the quarrel lay between a claimant and the Government alone, *Barry* v. *United States*, 229 U. S. 47, *John P. Squire Co.* v. *United States*, 90 C. Cls. 276. It has been allowed against an assignee of the claimant, *McKnight* v. *United States*, 13 C. Cls. 292, affirmed 98 U. S. 179, and also in favor of the United States where the debt was due to one of its agencies, *Cherry Cotton Mills, Inc.* v. *United States*, 327 U. S. 536.

But where the debts were not mutual, and third parties had an interest in the claim on the one side but no liability for the offset on the other side, the right to set-off has been denied the Government. In cases where suits were brought to enforce the claims of partnerships, attempts to claim set-offs against individual members of the partnerships were denied. *Boehm* v. *United States*, 20 C. Cls. 142, *Marietta Manufacturing Company* v. *United States*, 61 C. Cls. 122. This is in conformity with the notion that the debts must be mutual to be balanced against one another. The principal is illustrated in *Gray* v. *Rollo*, 18 Wall. 629, where a bankrupt insurance company was the holder of notes signed by Gray. Gray was also a member of a partnership to which the insurance company was indebted upon insurance policies. When the insurance company proceeded to enforce payment of Gray's notes, he raised by way of offset, the claims of his partnership upon the policies. In denying

this defense because of the lack of mutuality of the balancing credits, it was said:

> "The insurance company, so far as appears, took the notes without any reference to the policies of insurance; and Gray Brothers insured with the Company without any reference to the notes. Neither transaction was entered into in consequence of or in reliance on the other; and no agreement was ever made between the parties that the one claim should stand against the other."

In the case at bar, not only did the surety know nothing of the claim now endeavored to be used as the basis of set-off, but it did not even arise until subsequent to the giving of the bonds securing the contract.

In discussing this subject it was said in *Scott* v. *Armstrong*, 146 U. S., 499, at p. 507.

> "The right to assert set-off at law is a statutory creation, but courts of equity from a very early day were accustomed to grant relief in that regard independently as well as in aid of statutes upon the subject.
>
> "In equity, relief was usually accorded, says Mr. Justice Story (Eq. Jur. paragraph 1435), 'where, although there are mutual and independent debts, yet there is a mutual credit between the parties, founded, at the time, upon the existence of some debts due by the crediting party to the other. By mutual credit, in the sense in which the terms are here used, we are to understand, a knowledge on both sides of an existing debt due to one party, and a credit by the other party, founded on, and trusting to such debt, as a means of discharging it.' "

In the case at bar it is obvious that the transactions between the United States and the contractor were in no sense based upon the knowledge of existing debts, or upon the extension of credit based upon that knowledge. On the contrary, the United States took the precaution of obtaining independent security for the performance of each obligation assumed by the contractor, and obviously, the case

does not come within that class where equity permits set-offs because of connections between the demands. The allowance of a right of set-off, under the circumstances of this case, would result in the diversion of the contract funds from the payment of bills for labor and material which created the work, and would deprive the surety of that security to which it is entitled by well recognized authority. Such a result would be inequitable.

The Government seems to proceed on the assumption that its right of set-off is a legal right (Petitioner's brief, p. 38-39). In this, it is mistaken. The statute upon which petitioner relies, as creating a legal right of set-off, R. S. 236,[6] is no more than an organic provision assigning to the General Accounting Office the function of settling and adjusting claims by or against United States. That statute creates no substantive rule to regulate and control adjustments and set-offs to be made by the General Accounting Office. It provides merely that the General Accounting Office shall apply such stubstantive law as may be available for these purposes. The propositions which the General Accounting Office must apply in effecting set-offs are equitable in nature.

Since the debts are not mutual, and because it would be inequitable to balance them against one another to the damage of the surety, no case for an offset is made. It is submitted that the Court of Claims was correct in rejecting the contention of the General Accounting Office on this point.

3. The Equitable Doctrines Which Have Been Applied in These Cases Support the Surety's Position.

A wealth of authority in the Circuit Courts of Appeal has established beyond any question the right of a surety to be reimbursed out of the contract balances where it has either completed the work, or paid suppliers of labor and material. This result has been reached by awarding to the surety subrogation to the rights of the United States, to

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[6] App. p. 25.

the rights of the labor and material furnishers or to the rights of the contractor and by declaring the contract proceeds subject to an equitable lien. The decisions are substantially unanimous in result, although the theories assigned to support them vary according to the necessities of individual cases. It is the purpose of this discussion to show that the decisions based upon equitable principles are in entire consonance with the proposition advanced by the respondent here, that it has a direct legal right to these contract proceeds.

The first case to come before this Court involving the rights of the surety upon a defaulted Government contract was *Prairie State National Bank v. United States*, supra. In that case the surety had completed the work after the contractor's default. It was held that the surety was entitled to subrogation *to the rights of the United States*, and that its subrogation must be considered as arising from and relating back to the date of the original contract. It was concluded that the surety became entitled to resort to the securities and remedies which the United States, the creditor, were capable of asserting against the contractor, and that one of such remedies was the right arising from the original contract, to appropriate the monies retained for the reduction of damage.

In re Scofield Co., 215 Fed. 45 (C. C. A. 2nd) presents an instance where the contractor completed the work, but failed to pay furnishers of labor and material. The retained percentages had come into the hands of the contractor's trustee in bankruptcy. The surety paid the claims and then asserted its right to the contract balance. The Court said, at p. 47:

> "The question thus presented is whether, under the circumstances stated, the surety of the bankrupt contractor who has paid the claims of the laborers and materialmen has any equity in this so-called reserved fund which it can assert to the exclusion of the general creditors."

and again, at p. 50:

"We are unable, however, to see that any real difficulty exists as to the rules which govern the facts of this case. It is not disputed that the claims which the Fidelity Company has satisfied are claims which it was the duty of the Scofield Company to pay. In making the payments it did the Fidelity Company discharged obligations due from the Scofield Company for the performance of which the Fidelity Company was bound under the obligation of its suretyship. When the Fidelity Company assumed the obligation of suretyship its equity at once commenced with its obligation to see that the Scofield Company duly performed all the obligations which the contract with the Government imposed upon it, including its obligations to promptly pay the laborers and materialmen. The Supreme Court in *Prairie State Bank* v. *United States*, 164 U. S. 227, 233, 17 Sup. Ct. 142, 41 L. Ed. 412 (1896), held that a stipulation in a building contract for the retention until the completion of the work of a certain portion of the consideration is as much for the indemnity of him who may be quarantor of the performance of the work as for him for whom the work is to be performed, and that it raised an equity in the fund to be created. In accordance with this doctrine the equity of the Fidelity Company in this reserved fund cannot be successfully questioned. And the fact is quite immaterial that the contract which the Scofield Company made with the government provided simply for the retention of the fund until the completion of the work. A similar provision existed in the contract in the Prairie State Bank Case, but that fact did not prevent the Supreme Court from regarding the reserved fund as withheld for the benefit of the surety, as well as for the protection of the government. The doctrine of that case was reasserted by the Supreme Court in *Henningsen* v. *United States Fidelity & Guaranty Co.*, 208 U. S. 404, 28 Sup. Ct. 389, 52 L. Ed. 547 (1908). These cases show that the equity of the surety who pays the debts arising under the contract will take precedence of any assignment of funds due from the Government made by the contractor. *A fortiori* the equity of the surety must take precedence of the general creditors."

Henningsen v. *United States Fidelity & Guaranty Company*, 208 U. S. 404, developed out of a situation where the contractor had completed the work but had failed to pay furnishers of labor and material. They were paid by the surety pursuant to its Heard Act[7] bond, but the right to the contract proceeds was contested by the contractor's assignee. In holding that the surety was entitled to subrogation and to reimbursement from the contract proceeds this Court said, at p. 410.

> "The guaranty company was surety on that contract. Its stipulation was not merely that the contractor should construct the buildings, but that he should pay promptly and in full all persons supplying labor and material in the prosecution of the work contracted for. He did not make this payment, and the guaranty company, as surety, was compelled to and did make the payment. Is its equity superior to that of one who simply loaned money to the contractor, to be by him used as he saw fit, either in the performance of his building contract or in any other way? We think it is. It paid the laborers and materialmen, and thus released the contractor from his obligations to them, and to the same extent released the Government from all equitable obligations to see that the laborers and supplymen were paid. It did this not as a volunteer, but by reason of contract obligations entered into before the commencement of the work."

See also:

Hardaway v. *National Surety Company*, 211 U. S. 552;

Belknap Hardware & Mfg. Co. v. *Ohio River & Contract Co.*, 271 Fed. 144 (C. C. A. 6th);

Morgenthau v. *Fidelity & Deposit Co. of Maryland*, 94 F. (2d) 632.

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[7] App. p. 26.

It has been said:

> "That the equitable lien thus recognized arose at the time of the execution of the bond and was superior to the assignment to the appellant bank is decided by the great weight of authority" *Exchange State Bank* v. *Federal Surety Co.* 28 F. (2d) 485 (C. C. A. 8th), at p. 488.

In another instance where both the contractor and the sureties had become insolvent, furnishers of labor and material were recognized as having a right of lien upon the contract proceeds, and that right was enforced at their own instance, *Philadelphia National Bank* v. *McKinlay*, 63 App. D. C. 296, 72 F. (2d) 89, cert. den. 293 U. S. 583.

In *American Bonding Co.* v. *Central Trust Co.*, 246 Fed. 400 (C. C. A. 7th), the contractor had become bankrupt. The surety had given a bond in the amount of $1,250.00, conditioned for payment of persons furnishing labor and material to the work. Of the contract fund, $2,000 had come into the hands of the trustee in bankruptcy. It was said by the Court at p. 402:

> "The $2,000.00 fund in the hands of the trustee in bankruptcy stands charged with the same equities as to the materialmen and the surety upon the bond who had paid the materialmen as it was bound to do, as when it was undistributed in the hands of the United States. Whatever rights were acquired by reason of the contractor's assignment and payment thereon by the United States, were subject to the right of the materialmen and surety on the bond to have their claims paid in full. Henningsen v. United States Fidelity & Guaranty Co., 208 U. S. 404, 410, 28 Sup. Ct. 389, 52 L. Ed. 547.
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> * * * * *
>
> "That the surety, on the payment of labor and material claims, was subrogated and that its equity attached as of the date of the bond, and that a mere volunteer's rights would be subject to those of the surety who pays the labor and material bills, was clearly laid down in Prairie State Bank v. United

States, 164 U. S. 227, 240; 17 Sup. Ct. 142, 41 L. Ed. 412. This was approved in Henningsen v. United States, supra.

> "In the case at bar, the assignee of the contractor stands in the position of a mere volunteer and is not therefore entitled to the benefit of the doctrine of subrogation. Under the authorities quoted, the materialmen and the surety in the case at bar have a prior right to the extent of their claims in the fund so in the hands of the trustee in the nature of an equitable lien: It precedes the rights of assignees of the contractor and also those of the general creditors.
>
> "There can be no doubt but that the trustee in bankruptcy took the fund, as above stated, charged with the payment of claims of the materialmen and of th surety on the bond as prior liens thereon and with the duty of making distribution of said several sums so due thereon."

See also *Moran* v. *Guardian Casualty Co.*, 64 App. D. C. 188, 76 F. (2d) 438, from which the Court of Claims quoted at length in its opinion (R. 21).

The equities which are enforced in favor of the surety extend as well to current or progress payments as to retained percentages reserved under the contract. It was said in *Lacy* v. *Maryland Casualty Company*, 32 F. (2d) 48 (C. C. A. 4th) at page 51:

> "The rule is well settled that, independently of assignment, the surety on a contractor's bond, who completes the contract on default of the principal, is subrogated to the rights of the obligee, and, to the extent necessary to reimburse himself, has an equity in the funds due the contractor, which is superior to that of a mere assignee." Citing cases. * * *
>
> "The question arises whether this superior equity of the surety extends to the current estimates payable under the contract or merely to the retained percentage. We think that it extends to both. The equity arises because of the obligation of the surety to perform the contract of the principal. Upon his performance of this contract, equity subrogates him to all rights of the

obligee as against the principal. Now the obligee, upon default of the principal, is without doubt entitled to apply all monies unpaid toward the performance of the contract, ignoring any assignments by the principal; and it necessarily follows that the surety upon performing the contract, being subrogated to the rights of the obligee, is entitled to the monies unpaid so far as necessary to reimburse his loss. If the surety, instead of performing the contract, elects to pay damages, it can be held for no more than the amount which the obligee is compelled to pay to complete the work over and above the amount which it has on hand at the time of the principal's default, for this is all the damage that the surety sustains. But when this happens the surety receives the benefit of the unpaid current estimates as well as the retained percentages. Equity, of course, will not place him in worse position where he performs the contract of the principal in accordance with his obligation than where he elects to respond in damages."

The fund which this Court awarded to the furnishers of labor and material in *Martin* v. *National Surety Company, supra,* consisted of both progress payments and retained percentages.

Nor does the division of the surety's liability into two bonds, one conditioned for completion of the work, and the other for payment of labor and material furnishers affect the result. In *Riverview State Bank* v. *Wentz*, 34 F. (2d) 419 (C. C. A. 8th), a contractor with a state agency had given two such bonds required by two state statutes, but had failed to pay furnishers of labor and material. They were paid by the surety on that bond. The Circuit Court of Appeals held that the surety was entitled to subrogation and that its right was superior to that of an assignee of the contractor. It was said (p. 421):

"Obviously, it makes no difference in the law that there was but one statute, one bond and one surety, in the Henningsen Case; while here there are two statutes, two bonds, and but a single surety. The bond here for completion of the work is nowise directly in question or

in issue. The case would be the same if the latter bond never had been executed. Nothing seems more obvious, or plainer than that the mere adventitious fact that the Guaranty Company happens to be the surety on both of the bonds made in this case, cuts no earthly figure in the law of the case."

Thus it is seen that equity has recognized and freely enforced the rights of the surety and of the labor and material furnishers to the fund which constitutes the contract proceeds.* Nor is there any reason why when the work is finished and furnishers of labor and material have been paid by the surety, that the Government should not, in full recognition of its liability pay the agreed price therefor to the surety, even though it may have taxes and other unrelated claims due it from the contractor.

4. Comments on the Government's Brief.

The Government urges that greater convenience will result if the surety is required to sue the contractor. (Petitioner's brief, p. 20) It overlooks the fact that the surety and the contractor have already engaged in litigation in the very proceeding in which the respondent was appointed receiver. It is quite obvious that neither the Government nor the surety entertain prospects of satisfying their claims except from the fund here involved. Although there is no indication that the contractor is insolvent, the record shows plainly that it failed to pay numerous persons furnishing labor and material under its contracts, and likewise failed to pay the Government's claim on the St. Louis job and that none of these items have been paid by the contractor down to this time. Relief in matters of this kind has never been predicated so much upon insolvency as upon the recognition that the surety had a special interest in the con-

* The Government's reference to conflict of decisions in this field (Petitioner's Brief, p. 28) will be found to relate principally to cases involving local law or contracts and bonds having provisions which controlled the decision of individual cases.

tract proceeds which was entitled to the protection of the courts.

The Government suggests, in its brief, (Petitioner's brief, p. 22) that the respondent is a special receiver for the fund and as such must rely on the rights of the contractor thereto. It is entirely apparent from the order of the District Court, appointing respondent (R. 5-6) that the receiver was appointed for the benefit of the surety, and that the proceeds of the receiver's collection will go for the surety's reimbursement. Under those circumstances, the receiver succeeds to, and is entitled to enforce all claims which the surety might have against the contract proceeds. *Samuel Olson and Company* v. *Voorhees, et al.*, 292 Fed. 113 (C. C. A. 3d); *Hart* v. *Barney & Smith Mfg. Co.*, 7 Fed. 543 (C. C. D., Ky); *Bell* v. *New York Safety Steam Power Co.*, 183 Fed. 274 (C. C., S. D. N. Y.) *Hamor* v. *Taylor-Rice Engineering Co.*, 84 Fed. 392 (C. C., Del.)

The Government has urged that a surety cannot become subrogated to the debt which it pays unless it pays the whole debt, or if is otherwise satisfied (Petitioner's brief, p. 34) and endeavors to apply that rule to the case in hand. That rule, as illustrated by *United States* v. *National Surety Company*, 254 U. S. 73, and *Jenkins* v. *National Surety Company*, 277 U. S. 258, applies only to the *particular* debt which the surety has secured. That rule has never been extended to the point of saying that the surety could not be subrogated to the debt which it had paid in full as long as the creditor had any other claims against the debtor. In the case at bar the Government has no claim in connection with the contracts which the surety bonded since they have been satisfied in full. Accordingly, *United States* v. *National Surety Company*, *supra*, raises no barrier to the allowance of subrogation.

Where security is pledged for the obligation which the surety has undertaken, the creditor is not free to avail himself of that security for the payment of other obligations due him by the debtor. In *City National Bank of*

Ottawa v. Dudgeon, 65 Ill. 11, the debtor owed the bank several obligations among which was a note secured both by a mortgage and a surety. The surety paid the note and thereafter the bank endeavored to satisfy other of its claims against the debtor out of the mortgaged land. The right to do this was denied by the Court which held the surety entitled to subrogation to the security of the creditor for the particular debt which the surety had paid. This doctrine is summarized in Pomeroy's Equity Jurisprudence 5th Ed. (Symons) Vol. 4, ¶ 1419, p. 1075, as:

> "It necessarily follows from the surety's right of subrogation that the creditor cannot, without the surety's assent, surrender, give up, release, or discharge any such securities, or render them in any way unavailable to the surety, either by his own acts or omissions. If he does so, the surety's liability is thereby discharged, wholly or partially, as the case may be."

Reference is made in the Government's brief (p. 38-39) to the fact that the Treasury Department as well as the General Accounting Office have followed a practice of making set-offs for many years past. There can be no quarrel with the accuracy of this statement but on the other hand there is no line of precedents under which either of those offices may invade contract funds to the prejudice of sureties which had either completed the work or paid labor and material claims. And the Government admits that the decisions of the courts are adverse to it on this point. It is quite unlikely that the Government has ever attempted to make an offset of unrelated items against progress payments in the early stages of the work, although this would be in conformity with the position the Government now takes.

CONCLUSION.

The money which is here involved represents contract proceeds amounting to no more than, and as to some contracts less than, the amount of claims of unpaid labor and material furnishers. The money here involved was earned

by the surety which paid for this much of the labor and material which created the work. To the same extent the contractor defaulted under both its contract and bond and forfeited its right to further contract payments. The money here involved is in reality that of the surety.

The whole implication of the transaction is that the contract proceeds were a fund to be devoted to the construction of the work. The Government is not free to divert these monies to the payment of its unrelated debts, not only because the clear intention of the parties was otherwise, but also because the Government has the same responsibilities with respect to its contracts as a private person. *Perry* v. *United States*, 294 U. S. 330.

> "Punctilious fulfillment of contractual obligations is essential to the maintenance of the credit of public as well as private debtors." *Lynch* v. *United States*, 292 U. S. 571, at p. 580.

It is illogical and absurd that the surety for one contract should in effect become a surety for all of the contractor's debts to the government as the direct result of its coming forward and performing those obligations of the contractor which it guaranteed. And this without regard to whether the unrelated transaction long antedated or followed the giving of the bond. Such a result can be achieved only by attaching more importance to bookkeeping than to substance.

Not only this, but clearly there is a want of mutuality between the claim of the Government on the one hand arising from the contractor's failure to paint the St. Louis Post Office and the claim of the surety on the other hand to receive the contract proceeds to the extent that it fulfilled the contractor's obligation to its supplymen. There can be no presumption that the parties intended to allow the credits and debts arising out of the independent transactions to be credited against one another. On the contrary, the taking of security in connection with each transaction indicates that it was the intention of the Government, the

contractor, and the surety to treat each transaction as independent and unrelated.

It is submitted that in right and justice the fund which represents the completed work should be awarded to the surety which fulfilled the requirements of the contracts and bonds by paying for the labor and materials used in the work.

Respectfully,

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APPENDIX.

1. R. S. 236 is as follows:

All claims and demands whatever by the Government of the United States or against it, and all accounts whatever in which the Government of the United States is concerned, either as debtor or creditor, shall be settled and adjusted in the General Accounting Office. (R. S. 236; June 10, 1921, c. 18, 305, 42 Stat. 24; 31 U. S. C. 71)

2. Pertinent parts of the Miller Act which directs the contracting agency to obtain the completion and material supplier's bonds are as follows:

Before any contract, exceeding $2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as "contractor":

(1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.

(2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person. Whenever the total amount payable by the terms of the contract shall be not more than $1,000,000 the said payment bond shall be in a sum of one-half the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $1,000,000 and not more than $5,000,000, the said payment bond shall be in a sum of 40 per centum of the total amount payable by the terms of the contract. Whenever the total amount payable by the terms of the contract shall be more than $5,000,000 the said payment bond shall be in the sum of $2,500,000.

* * * * *

(Aug. 24, 1935, c. 642, 1; 49 Stat. 793; 40 U. S. C. 270a et seq.)

3. Pertinent parts of the Heard Act which preceded the Miller Act are as follows:

> Any person or persons entering into a formal contract with the United States for the construction of any public building, or the prosecution and completion of any public work, or for repairs upon any public building or public work, shall be required, before commencing such work, to execute the usual penal bond, with good and sufficient sureties, with the additional obligation that such contractor or contractors shall promptly make payments to all persons supplying him or them with labor and materials in the prosecution of the work provided for in such contract; and any person, company, or corporation who has furnished labor or materials used in the construction or repair of any public building or public work, and payment for which has not been made, shall have the right to intervene and be made a party to any action instituted by the United States on the bond of the contractor, and to have their rights and claims adjudicated in such action and judgment rendered thereon, subject, however, to the priority of the claim and judgment of the United States. If the full amount of the liability of the surety on said bond is insufficient to pay the full amount of said claims and demands, then, after paying the full amount due the United States, the remainder shall be distributed pro rata among said interveners.

* * * * *

(Aug. 13, 1894, c. 280, 28 Stat. 278; Feb. 24, 1905, c. 778, 33 Stat. 811; Mar. 3, 1911, c. 231, 291, 36 Stat. 1167; 40 U. S. C. 270)

SUPREME COURT OF THE UNITED STATES

No. 847.—October Term, 1946.

The United States, Petitioner, *v.* The Munsey Trust Company of Washington, D. C., Receiver.	On Writ of Certiorari to the Court of Claims.

[June 23, 1947.]

Mr. Justice Jackson delivered the opinion of the Court.

This case presents a problem arising out of contracts for public building construction and repair. The rights *inter sese* of contractor, surety, assignees and government have been productive of much litigation, but we have not heretofore had to decide whether percentages retained pursuant to contract by the United States may be subjected to its set-off claims despite the claims of a surety who has paid laborers and materialmen.

In May and July, 1940, six contracts were made between the United States and the Federal Contracting Corporation, in which the corporate contractor agreed to paint and repair certain federal buildings. Each contract conformed to the requirements of statute, 49 Stat. 793, 40 U. S. C. § 270a, *et seq.*, by providing for two surety bonds, one conditioned on the completion of the work within the contract period, and the other on the payment of those furnishing labor and material to the contractor. The Aetna Casualty and Surety Company signed those bonds, each of which assigned to it the contractor's claims against the government for sums due on the contracts whenever the surety should be compelled by default of the contractor to fulfill its obligations.[1]

[1] These assignments were of course invalid against the United States, R. S. § 3477, 31 U. S. C. § 203; *Martin* v. *National Surety Co.*, 300 U. S. 588, but they enable the surety to prevail over the contractor if there is contest between them.

The work was completed by the contractor apparently in 1940, and accepted by the government. The surety therefore was not called upon to make good the promise of the performance bonds. But the contractor did not pay $13,065.93 owed to persons who had supplied labor and material for performance of five of the six contracts. This indebtedness the surety paid between April and September, 1941 as the payment bonds obliged it to do.

Under the customary terms of its contracts, the government had retained percentages of the progress payments due to the contractor. This retained money, on acceptance of the work, amounted to $12,445.03, but it was not disbursed. On October 18, 1940, the Federal Contracting Corporation submitted a bid to the United States for another painting job, in St. Louis. That bid was accepted, but the contractor then failed to enter into contract for the work. Another contractor painted the building for a price which left the government considerably more out-of-pocket than it would have been had Federal undertaken performance at its bid price. It is undisputed that $6,731.50 is the amount of damages sustained by the government after it had applied the contractor's deposit of $415.00 in reduction.

Almost inevitably, court process was begun to untangle claims to the money the United States still owed on the six contracts. A stockholder of Federal asked the United States District Court for the District of Columbia to appoint a receiver [2] to collect the money. The Aetna Casualty and Surety Company was made a party to that action. Respondent here, the Munsey Trust Company, was appointed receiver with directions to demand and

[2] Such proceedings to appoint a receiver in the District of Columbia are for the purpose of taking possession of a fund or property and to prevent its loss or dissipation. Insolvency is not a necessary allegation, *Houston* v. *Ormes*, 252 U. S. 469, and there is no claim in this case that the contractor is insolvent.

authority to receive from the United States the proceeds of the six contracts. The order of appointment also recited that "the proceeds of all collections made by the Receiver pursuant to this order shall be held for the reimbursement of the defendant The Aetna Casualty and Surety Company for expenditures made by it in the payment of furnishers of labor and material under the several contracts of the Federal Contracting Corporation."

On demand by the receiver for the amounts due, the General Accounting Office deducted the government's claim of $6,731.50 and paid over $5,713.53. Aetna, by letter to the Comptroller General, protested the government's settlement by set-off and asserted its right to an additional $3,568.23.[3] The receiver also protested the set-off and demanded $3,143.23 for reimbursement of the surety. It relied upon *Maryland Casualty Co. v. United States*, 100 C. Cls. 513, 53 F. Supp. 436. The Acting Comptroller General declined to follow the opinion of the Court of Claims, in the absence of ruling by this Court, and rejected the protests. When the receiver reported its efforts to the district court, it was ordered to turn over to the surety the money collected, less $500. That sum was for prosecution of suit in the Court of Claims for the recovery of whatever other moneys "may be due under the contracts of the Federal Contracting Corporation." This action was begun, and the Court of Claims gave judgment for $3,568.23 to respondent. We granted the government's petition for certiorari because of the importance and novelty of the question and the cumulative effect of *Maryland Casualty Co. v. United States*, *supra*, and the decision below. — U.S. —.

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[3] The surety did not and could not claim the whole amount retained by the government. The payments for which it was liable and which it paid, on two of the contracts exceeded, and, on the other four, were less than, the amounts retained on each particular contract.

In these cases, it is usual for the rights relied upon to be largely derivative or subrogated ones. Decision will be attended with unnecessary confusion and difficulty if it is not clear whose rights are being asserted and who claims them. The Court of Claims treated this case as though the surety were plaintiff. But the district court directed the receiver to bring the suit. Its order of appointment made it the representative of Federal Contracting Corporation, although the sums it was to collect were to be held for the reimbursement of Aetna. The second order authorized this action to collect whatever other money might be held to be due under the six contracts which the government would not voluntarily pay. Certainly, the receiver sued at least in the right of Federal, but since its efforts were directed to be for the benefit of Aetna, it might assert the surety's rights also. *Samuel Olson & Co.* v. *Voorhees,* 292 F. 113, 115.

If the right of the United States to make the set-off were opposed only by the claims of the contractor, the case would present no difficulty. The government has the same right "which belongs to every creditor, to apply the unappropriated moneys of his debtor, in his hands, in extinguishment of the debts due to him." *Gratiot* v. *United States,* 15 Pet. 336, 370; *McKnight* v. *United States,* 98 U. S. 179, 186. More than that, federal statute gives jurisdiction to the Court of Claims to hear and determine "All set-offs, counterclaims, claims for damages, whether liquidated or unliquidated, or other demands whatsoever on the part of the Government of the United States against any claimant against the Government in said court . . ." Judicial Code § 145, 28 U. S. C. § 250 (2). This power given to the Court of Claims to strike a balance between the debts and credits of the government, by logical implication gives power to the Comptroller General to do the same, subject to review by that court. Insofar as the suitor in the Court of Claims as-

serted the contractor's title to the sum in dispute, that court was under statutory duty to recognize the undisputed claim for damages of the United States. *Cherry Cotton Mills, Inc.* v. *United States,* 327 U. S. 536.

But the surety urges that it is subrogated also to the rights of laborers and materialmen whom it paid and of the United States. From *Prairie State Bank* v. *United States,* 164 U. S. 227, to *American Surety Co.* v. *Sampsell,* 327 U. S. 269, we have recognized the peculiarly equitable claim of those responsible for the physical completion of building contracts to be paid from available moneys ahead of others whose claims come from the advance of money. But in all those cases, the owner was a mere stakeholder and had no rights of its own to assert. Respondent tells us that here the United States is in the same position and that as a general creditor, it has no more right to the money which it holds than does any other general creditor of the contractor.

At the time demand for payment was made by the receiver, the claim of the United States on the St. Louis contract was extant for some time. The disbursing officers, therefore, did not concede that they held the entire amount of the retained percentages for distribution to the contractor or others. And one whose own appropriation and payment of money is necessary to create a fund for general creditors is not a general creditor. He is not compelled to lessen his own chance of recovering what is due him by setting up a fund undiminished by his claim, so that others may share it with him. In fact, he is the best secured of creditors; his security is his own justified refusal to pay what he owes until he is paid what is due him.

But the infirmity in respondent's case goes deeper. If the United States were obligated to pay laborers and materialmen unpaid by a contractor, the surety who discharged that obligation would claim subrogation.

But nothing is more clear than that laborers and materialmen do not have enforceable rights against the United States for their compensation. *Cf. H. Herfurth, Jr., Inc.* v. *United States*, 89 Ct. Cls. 122; see *Schmoll* v. *United States*, 105 Ct. Cls. 415, 455; *Maryland Casualty Co.* v. *United States*, 53 F. Supp. 436, 440. They cannot acquire a lien on public buildings, *Hill* v. *American Surety Co.*, 200 U. S. 197, 203; *Equitable Surety Co.* v. *McMillan*, 234 U. S. 448, 455, and as a substitute for that more customary protection, the various statutes were passed which require that a surety guarantee their payment. Of these, the last and the one now in force is the Miller Act under which the bonds here were drawn.

The surety says, nevertheless, that the laborers and materialmen may have a lien, or something in the nature of a lien on the retained percentages. Its argument runs into logical difficulties. For it asserts that the moneys are retained by the government as much for assurance that the contractor will perform his contract by paying the laborers and materialmen as by completing the work on time. It is said to follow that so long as they remain unpaid, the contractor may not demand payment and the government would be justified in refusing to disburse the retained percentages.[4] In that case, how may the laborers and materialmen have a lien upon money which the United States may legally keep? Surely it is not intended that the laborers and materialmen may claim payment of that which is not due to the contractor. We are aware that the laborers and materialmen have been paid, so that by no interpretation of the contracts between government and contractor

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[4] If the money is retained only to assure performance of the work, then the contractor might compel payment when the work is accepted. In that case, the surety's argument fails, since obviously, before paying, the government might set off claims against the contractor.

can there be restrictions on paying out the money retained. It is said that it was the surety's payment of those claims which released the asserted contract restrictions. In relying on the rights of the laborers and materialmen, however, the surety must establish that those rights existed before their claims were paid. For it is elementary that one cannot acquire by subrogation what another whose rights he claims did not have. Once the laborers and materialmen have been paid, either by contractor or surety, they have no rights in any fund. If before they are paid, the fund to which they are said to be entitled to look is unavailable for the very reason that they are unpaid, the surety relies on nothing when it relies on those nonexistent "rights." One who rests on subrogation stands in the place of one whose claim he has paid, as if the payment giving rise to the subrogation had not been made. See *Aetna Life Insurance Co.* v. *Middleport*, 124 U. S. 534, 548. He cannot jump back and forth in time and present himself at once as the unpaid claimant and again, under the conditions as they have changed because payment was made.

We need not decide whether laborers and materialmen would have any claim to the retained percentages, if both contractor and surety failed to pay them. Even if they do, certainly these would be rights to which the surety could not be subrogated for by hypothesis it would have done nothing to earn subrogation.

The surety has yet another party whose rights it would claim, if it cannot prevail by substitution for contractor or laborers and materialmen. This contention too was sustained by the Court of Claims when it said that the rights of the United States devolved upon the surety because of its payments. We are told that the United States retained the money to assure performance of all the obligations of the contractor, and that the surety is entitled to apply that security to indemnify itself for

performing one of those obligations. This is by analogy to the rule that an obligee, as against a surety, may not apply security in satisfaction of debts ~~other~~ than the one it secures. See 4 Pomeroy, Equity Jurisprudence (5th ed.) 1075. But although we have assumed, for the purposes of another argument, that assurance that laborers and materialmen will be paid is one of the reasons for retaining the money, it seems more likely that completion of the work on time is the only motive. *California Bank* v. *United States Fidelity & Guaranty Co.*, 129 F. 2d 751; see *Schmoll* v. *United States*, 105 C. Cls. 415, 455; *Maryland Casualty Co.* v. *United States, supra* at 439. It is hardly reasonable to withhold money in order to assure payments which perhaps can be made only from the money earned. In any event, we are not prepared to apply law relating to security to unappropriated sums which exist only as a claim.

Finally, the surety by reference to the *Maryland Casualty* case, *supra*, suggests that it has rights of its own in the money which the government retained. It argues that the implication of the several contracts among government, contractor and surety was that the moneys earned under the repair contracts would be available to pay claims arising under each job. However, if statute did not require a surety, there could be no question that the government would have the right of set-off. Respondent's contention then comes to this: that by requiring the contractor to furnish assurances that he will perform his obligations to laborers and materialmen, the government has deliberately decreased the ordinary safeguards it would have had to enforce the contractor's obligations to it. We see nothing in the words of the contract or the statute to lead us to this conclusion. On the contrary, the statutory provisions requiring a separate bond for payment of laborers and materialmen were enacted for their benefit, not to the detriment of the government.

It is the surety who is required to take risk. We have no warrant to increase risks of the government.

Respondent argues that if the work had not been completed, and the surety chose not to complete it, the surety would be liable only for the amount necessary to complete, less the retained money. Moreover, if the surety did complete the job, it would be entitled to the retained moneys in addition to progress payments. The situation here is said to be similar. But when a job is incomplete, the government must expend funds to get the work done, and is entitled to claim damages only in the amount of the excess which it pays for the job over what it would have paid had the contractor not defaulted. Therefore, a surety would rarely undertake to complete a job if it incurred the risk that by completing it might lose more than if it had allowed the government to proceed. When laborers and materialmen, however, are unpaid and the work is complete, the government suffers no damage. The work has been done at the contract price. The government cannot suffer damage because it is under no legal obligation to pay the laborers and materialmen. In the case of the laborers' bond, the surety has promised that they will be paid, not, as in the case of performance bond, that work will be done at a certain price. The law of damages is therefore not pertinent to the payment bond.

We hold that the government properly used its right to set off its independent claim and the judgment below must be

Reversed.

MR. JUSTICE BURTON dissents.

MR. JUSTICE DOUGLAS took no part in the consideration or decision of this case.